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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.; Frederic 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 lump-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.

➢ 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.

➢ 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 SERP benefits, or the NYSE's SERP, 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.

➢ 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 SERP 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 SERP 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.

III. SUMMARY OF INFORMATION GATHERED IN THE INVESTIGATION

A. Overview of Grasso's Compensation and Benefits at the NYSE

1. Grasso's NYSE Employment Pre-1995

Prior to becoming Chairman and CEO, Grasso had been employed at the NYSE for twenty-seven years.[3] His employment at the NYSE began on April 8, 1968, when he was hired as a clerk in the stock list department. He was promoted to Vice President in December 1977, Senior Vice President in November 1981, Executive Vice President in 1983, President and Chief Operating Officer in June 1988, and Executive Vice Chairman in January 1991. On October 6, 1994, the NYSE Board voted to appoint Grasso as the next NYSE Chairman and CEO, and he became Chairman and CEO on June 1, 1995.

In the years prior to becoming Chairman and CEO, Grasso had accumulated $6,571,397 in SERP benefits.[4] In 1994, the year before he became Chairman and CEO, Grasso's total compensation as President of the NYSE was $1,075,000, which was comprised of a salary and no bonus.[5] Prior to Grasso becoming Chairman and CEO, that position was held by William H. Donaldson. In 1994, Donaldson's compensation was $1,650,000 and his accumulated pension benefits totaled $3,557,083, which he received in a lump-sum benefit when he left the employment of the NYSE.[6]

2. Grasso's Employment Contracts as Chairman and CEO, 1995-2003

a. 1995 Contract

When Grasso assumed the position of Chairman and CEO, he entered into an employment agreement setting forth the terms of his employment.[7] The term of the agreement, dated May 11, 1995, was from June 1, 1995 to May 31, 2000, with automatic one-year extensions each year thereafter unless either Grasso or the NYSE took certain action to terminate the contract. Pursuant to that agreement, Grasso received a base salary of $1.4 million per year and had a minimum target bonus of $700,000. In addition to providing other benefits, the contract provided that, although Grasso would not participate in the NYSE SERP, he was entitled to receive a contractual SERP-like benefit that largely mirrored the SERP benefits provided to other NYSE employees.

As part of the negotiation of his 1995 employment contract, Grasso asked for and received a payout of all his accumulated SERP benefits up to that date, which totaled $6,571,397.[8] Grasso received this amount

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3 *See* NYSE 000972, 029836.

4 *See* NYSE 051061-62.

5 *See* NYSE 029810, 035466-67, 032813.

6 *See* NYSE 035466, 032811-A, 032814. Donaldson also received a special payment of $2.5 million at the time he left the NYSE. *See* 035466.

7 *See* NYSE 002904-28. Grasso also had an employment agreement when he was the President of the NYSE, from 1990 to June 1995. *See* 002879-99.

8 *See* NYSE 000054-59, 000088-91, 002900-02.

in a lump sum payment in connection with the signing of his 1995 contract. According to Grasso, he asked for the payout of his SERP account because he wanted the money for the purchase of a house.

During the period from 1995 through 1998, under his 1995 contract, Grasso's annual compensation was as follows:

Year	Compensation
1995	$ 2,164,583
1996	$ 3,000,000
1997	$ 5,200,000
1998	$ 6,000,000

b. 1999 Contract

In 1999, Grasso's employment agreement was renegotiated. On May 3, 1999, he entered into his second employment agreement as Chairman and CEO.[9] This agreement provided for Grasso to serve as Chairman and CEO from June 1, 1999 to May 31, 2005. Under this agreement, Grasso's base salary was $1.4 million and his minimum target bonus was $1 million. As with his 1995 contract, Grasso was again entitled to a contractual SERP-like benefit that largely mirrored the NYSE's SERP, as well as other benefits.

In connection with the signing of this agreement, Grasso was allowed to transfer out of his SERP account his accumulated SERP benefits as of that date. Specifically, Grasso was allowed to transfer from his SERP account to his SESP account a total of $29,928,062.[10] This SERP to SESP transfer, like the payout of Grasso's accumulated SERP benefits in 1995, was at Grasso's request.[11] Also pursuant to this contract, Grasso agreed to forego $5,188,964 in SERP benefits in connection with a change in the mortality table used by the NYSE to calculate SERP benefits.

The transfer of the $29,928,062 from Grasso's SERP account to his SESP account resulted in important benefits to Grasso. As discussed *infra*, under the SERP, an employee cannot collect a benefit until retirement, nor can an employee collect a benefit prior to age 55. If an employee leaves the NYSE prior to age 55, he or she forfeits his or her SERP benefit in its entirety. Moreover, SERP benefits are simply a book entry; they are not funded. Under the SESP, in contrast, there are no such limitations; once money is placed in an employee's SESP account, it is fully vested and can be invested by the employee. Thus, pursuant to the $29,928,062 SERP-to-SESP transfer, Grasso was able to transfer an unvested, unfunded book entry into a cash account, where it could be invested prior to retirement and prior to age 55, earning Grasso interest.

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9 *See* NYSE 029842-67.

10 *See* NYSE 030204.

11 In connection with the signing of his 1999 employment contract and the transfer of $29,928,062 from his SERP account to his SESP account, Grasso agreed to a permanent adjustment to the mortality table used for computing his SERP. This adjustment resulted in a reduction of $5,188,964 in Grasso's final lump-sum SERP benefits.

During the period from 1999 through 2002, under his 1999 contract, Grasso's annual compensation was as follows:

Year	Compensation
1999	$ 11,300,000
2000	$ 26,800,000
2001	$ 30,550,000
2002	$ 11,999,999

c. 2003 Contract

Beginning in 2002, Grasso again began renegotiating his employment contract.[12] These negotiations culminated in a new employment agreement for Grasso, which was executed on August 27, 2003. Under this agreement, Grasso was to serve as Chairman and CEO for a term from August 27, 2003 to May 31, 2007. The employment agreement provided Grasso with a base salary of $1.4 million and a minimum target bonus of $1 million.

In August 2003, before entering his 2003 employment agreement, Grasso had accumulated a total SERP benefit of approximately $119,359,786 (excluding interest made on prior SERP payouts).[13] Of that amount, $6,571,397 had been paid out to Grasso in 1995, and $29,928,062 had been transferred to Grasso's SESP account in 1999, leaving $82,860,327 in additional SERP benefits that had accumulated since May 1999 and had not been paid out or transferred out of his SERP account. With interest on the 1995 and 1999 payouts, the total present value of Grasso's SERP benefits in August 2003, pursuant to his 1999 contract, was over $125 million.

Pursuant to his 2003 employment agreement, Grasso received immediate SERP-related payouts as follows: (1) an immediate payout of $51,574,000 in additional SERP benefits; and (2) an immediate payout of the $29,928,062 that previously had been transferred from his SERP to his SESP account and which, by 2003, had grown to $33,608,000. Thus, as a result of the 2003 contract and prior contracts, by September 2003, Grasso had received payouts of his SERP benefits totaling $88,073,459 (again, excluding interest on the payouts in 1995 and 1999).

The 2003 contract also gave Grasso rights to future SERP payments. Specifically, the contract provided Grasso a right to receive yearly SERP payments of $7,138,000 from 2004 through 2007 (a total of $28,552,000) if he remained employed at the NYSE at the time each of those payments came due. In addition, the contract provided that Grasso had a right to receive potential additional amounts of SERP benefits when his employment at the NYSE ended, depending on various facts and circumstances regarding the termination of his employment.[14]

Also pursuant to the 2003 contract, Grasso was to receive a payout of deferred compensation that had accrued to date, and was to receive additional amounts of deferred compensation in the future. Specifically, pursuant to the 2003 contract, Grasso was to receive immediate payment of $54,304,000 in

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12 *See* NYSE 000945-69.

13 *See* Report of Johnson Associates Inc. ("Johnson Report") at 3-6, Exhibit 3.

14 Pursuant to the NYSE's direction, we separately will provide the NYSE with an analysis concerning the NYSE's rights and obligations under Grasso's 2003 employment contract in light of Grasso's resignation on September 17, 2003. Those issues are not addressed in this Report.

deferred compensation, and was to receive future payments of deferred compensation as follows: (a) CAP payments totaling $12,121,239, which would vest from July 2003 through July 2006; (b) $7,347,000 to be paid on February 1, 2006, representing Grasso's special payment of $5,000,000 awarded in 2000 that was payable on February 1, 2006, with 8% interest; and (c) $260,000 from Grasso's SESP account.

Thus, under the 2003 contract, Grasso was to receive an immediate payment of $139,486,000 in deferred compensation and benefits, and was scheduled to receive at least an additional $48,280,239 in deferred compensation and benefits in the future, from 2004 through 2007.

On or about September 2, the NYSE made its payout to Grasso (in two installments) of the $139,486,000 provided for under the 2003 contract.[15] On September 9, 2003, during a Board meeting, Grasso announced that he would forego receipt of the more than $48 million in future payments of deferred compensation and benefits specified under the 2003 contract.[16] On September 17, 2003, at a Board meeting that Grasso called specifically to address his potential resignation, Grasso advised the Board that he would resign if the Board asked him to do so and, when the Board decided to ask for his resignation, Grasso resigned.[17] These events are discussed in more detail in Section III.D.3.m., *et seq.*, *infra*.

3. Components of Grasso's Compensation and Benefits

During his tenure as Chairman and CEO, Grasso received both "compensation" – defined by the NYSE Human Resources Department as including salary, bonuses and deferred compensation awards – and "benefits"–defined by the NYSE Human Resources Department to include awards or contributions pursuant to the NYSE's standard and supplemental savings and retirement plans. Each component of Grasso's compensation and benefits is discussed below.

a. Compensation

Between 1995 and 2003, Grasso received compensation in several forms. Specifically, Grasso's compensation package over that period had five different components, though he did not receive every component each year: (1) Salary; (2) Incentive Compensation Plan ("ICP") awards; (3) Capital Accumulation Plan ("CAP") awards; (4) Long-Term Incentive Compensation Plan ("LTIP") awards; and (5) "Special Payments."

(i) Salary

Throughout his tenure as Chairman and CEO, Grasso's annual salary was set by contract.[18] In all three of Grasso's employment contracts as Chairman and CEO (1995, 1999, 2003), Grasso's annual salary was set at $1.4 million. Immediately prior to becoming Chairman, Grasso's salary was $1,075,000. Accordingly, for the year 1995, when Grasso spent approximately the first half of the year as President under his 1990 contract and the latter half of the year as Chairman and CEO under his 1995 contract, his total salary was approximately $1.2 million. In all subsequent years, Grasso received a salary of $1.4 million.

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15 *See* NYSE 029897-99, 024601-05.

16 *See* NYSE 024258-60.

17 *See* NYSE 024258-60.

18 Over the course of Grasso's tenure as Chairman and CEO, Grasso and former NYSE President William R. Johnston were the only NYSE employees to have written employment contracts.

(ii) Incentive Compensation Plan ("ICP")

The NYSE's ICP is a performance-based compensation system. In lay terms, the ICP award is a "bonus." When the ICP was created in the 1980s, the NYSE employees eligible to participate in the ICP were limited to senior executives. However, by 1999, with a few limited exceptions, all NYSE employees participated in the ICP.

Grasso participated in the ICP from the time it was established in the 1980s until 1990, when, pursuant to his 1990 employment contract, he was excluded from the ICP. When he became Chairman and CEO in 1995, and continuing thereafter, he again participated in the ICP, as his participation in the ICP was specifically provided for under his 1995 and 1999 employment contracts.

During Grasso's tenure as Chairman and CEO, all NYSE employees had a target ICP award level (a percentage of the employee's salary) that was based on the employee's salary grade (or, in the case of Grasso and Johnston, based on their contracts). In general, ICP target awards ranged from 10% of an employee's salary (*e.g.*, Grade 18) to 35% of an employee's salary (*e.g.*, Grade 37). Grasso's ICP target award was required to be a minimum of $700,000 under his 1995 employment contract (50% of his salary) and $1,000,000 under his 1999 and 2003 employment contracts (about 71% of his salary).[19]

ICP awards for all NYSE employees except senior executives were based in part on the performance of the NYSE and the employee's performance, as judged against certain criteria. Throughout Grasso's tenure as Chairman and CEO, the ICP performance evaluation for these employees had two components: (1) an objective or "empirical" component, through which performance was assessed against certain objective criteria, which were numerical measurements; and (2) a "Chairman's Award," through which Grasso made a subjective determination of the performance of the NYSE, taking into account non-numerical criteria. The former constituted 65% of the evaluation of the employee's performance, while the latter constituted 35% of the evaluation.

For senior executives, including the CEO (Grasso) and the NYSE President (William R. Johnston) or Co-Presidents (Catherine A. Kinney and Robert G. Britz) during Grasso's tenure, the ICP awards were determined each year by the Board of Directors after receiving a recommendation from the Compensation Committee. In the case of the President or Presidents, Grasso first made a recommendation to the Committee regarding the level of their ICP awards.

The Committee and Board had discretion in setting the ICP awards for Grasso and the President(s). Although the criteria that were used to determine the ICP awards for the non-senior executive employees were not applied in rote fashion to determine the ICP awards of Grasso and the President(s), those criteria were part of the information considered by the Committee in evaluating the appropriate level of the ICP awards for senior executives, including Grasso.[20]

Awards for each year were determined in February of the following year. For example, ICP awards for 2002 were determined in February of 2003. Beginning with the ICP award for 1997, program participants had the option of deferring all, some, or none of their ICP award.[21] In Grasso's case, every year that he

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19 *See* NYSE 035339-57, 036387-45, 033405-37, 031325-52, 033352-76, 033327-51, 033531-62, 046087-111.

20 The process employed by the Compensation Committee in establishing recommended ICP awards for Grasso each year during his tenure as Chairman and CEO is addressed in further detail at Section III.B., *infra*.

21 *See* NYSE 000607-20, 000635-37.

was Chairman of the NYSE he received an ICP award that exceeded his target ICP level, in most cases by a substantial amount. Between 1995 and 2002, Grasso's annual ICP awards were as follows:

Year	ICP Award
1995	$ 900,000
1996	$ 1,600,000
1997	$ 3,800,000
1998	$ 4,204,000
1999	$ 5,652,000
2000	$12,519,000
2001	$16,100,000
2002	$ 7,066,666

(iii) Long-Term Incentive Compensation Plan ("LTIP")

The NYSE's LTIP was a plan that, much like the ICP, awarded bonuses on the basis of an employee's performance in relation to certain pre-established targets. The LTIP was created in 1996. The first LTIP awards were given out in 1998. LTIP awards were given out for three years, from 1998 through 2000, and then the LTIP was discontinued effective May 1, 2001.[22]

Only employees at the Senior Vice President level and above were eligible for LTIP awards. The LTIP was designed to provide extra compensation to senior NYSE executives to make up for the fact that they could not receive stock options or other equity-based compensation components that many senior executives at large public corporations were eligible to receive.

The LTIP functioned much like the ICP except that, under the LTIP, the goals that were set were three-year NYSE-wide goals, as opposed to one year goals, and awards were based on three-year performance measured against certain targets, with each three-year frame representing a cycle. At the end of each cycle, an award was granted based upon performance against the goals. LTIP participants had the option of deferring all, some, or none of their LTIP award.

Grasso's initial minimum three year target LTIP award was $2 million. Pursuant to his 1999 employment contract, Grasso's minimum three-year target LTIP award was set at $2.5 million. Grasso received LTIP awards as follows:

Year	LTIP Award
1998	$ 396,000
1999	$ 948,000
2000	$ 1,081,000

According to various witnesses familiar with the LTIP and documents concerning the program, the LTIP was discontinued in May 2001 after the Compensation Committee concluded that it was difficult to identify meaningful criteria to accurately measure performance of the NYSE in three-year cycles, and because the LTIP did not allow for discretion in determining award levels.[23]

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22 *See* NYSE 000599-620, 012244-62, 012653-80, 011507-24.

23 *See* NYSE 029678, 023498.

By letter agreement dated August 30, 2001, between Grasso and Kenneth G. Langone, as Chairman of the Compensation Committee, Grasso and the NYSE agreed that, in light of the elimination of the LTIP, "it is intended that [Grasso's] potential future awards under the Exchange's [Annual ICP] will be increased to make up for the elimination of [Grasso's] incentive opportunities under LTIP. However, as in the past, there will be no guaranteed amount of compensation payable to [Grasso] under the Annual ICP."[24]

(iv) Capital Accumulation Plan ("CAP")

The CAP is a bonus type of compensation plan that was created and implemented at the NYSE in 1998 and remained in effect through the remainder of Grasso's tenure as Chairman and CEO. Although the CAP began prior to the termination of the LTIP, the CAP ultimately replaced the LTIP as a method of providing top executives of the NYSE deferred incentive compensation.[25]

The Compensation Committee determines which executives are eligible to participate in the CAP program. Initially, the only NYSE employees eligible to participate in the CAP were Catherine R. Kinney, Robert G. Britz, Edward A. Kwalwasser, and Georges Ugeux. However, by 2003, there were twelve participants in the CAP program, all of whom were top executives at the NYSE.[26] Although Grasso technically was not a CAP participant, his 1999 employment contract provided that he was entitled to a yearly CAP-like benefit that awarded him a bonus based on the same criteria applied under the CAP. The terms of Grasso's contractual CAP-like benefit largely mirrored the terms of the awards provided under the CAP to the other top NYSE executives who participated in the CAP.

The CAP provides that each participant in the plan receive an annual award based on a percentage of the total of his or her variable compensation, which is comprised of the employee's ICP award and LTIP award.[27] The percentage award levels vary and are designated individually for each executive in the program. For Grasso and the Co-Presidents (Britz and Kinney), the CAP award was set at 50% of the individual's variable compensation. Grasso's CAP award was set by his contract. For other employees, the CAP award is set at lower levels, such as 25% or 15% of the individual's variable compensation. These levels are set by the Compensation Committee based on the employee's position or level at the NYSE and other factors, including the extent of the Committee's commitment to ensure retention of the employee.

The CAP awards are not immediately vested when awarded. Instead, the CAP provides that, for the CAP awards to vest, the plan participants have to maintain their employment at the NYSE until they attain certain ages. Thus, the idea behind the CAP, somewhat like the reasoning behind the LTIP, was to provide the NYSE's top executives incentive to remain employed at the NYSE for extended periods, so as to allow their CAP awards to vest over time. Some of the directors and staff interviewed in the Investigation described the CAP's purpose as putting "golden handcuffs" on the NYSE's top executives so that they would stay at the NYSE.

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24 *See* NYSE 000125-27.

25 *See* NYSE 000282-89, 000638-49, 000650-52, 000653-56.

26 *See* NYSE 030655-58.

27 The LTIP and the CAP co-existed for only two years, 1999 and 2000, before the LTIP was discontinued. After the LTIP was discontinued, an individual's CAP award was a percentage of the individual's ICP award.

Each year, for each employee in the plan, the employee's CAP award is entered in a book account, *i.e.*, the amount is not funded but, rather, is simply entered on paper as a book entry. The CAP award remains as a book entry, and grows at a fixed rate of 8% per year until it vested. Vesting is based solely on the age of the employee. The CAP provides that CAP awards begin to vest when the employee attains age 55 and, as an employee reaches ages 56 through 59, more of his or her CAP awards vest, until all of the employee's CAP account becomes fully vested at age 60. The vesting table under the CAP depends on when the CAP award was given, as follows:

Vesting For CAP Amounts Awarded Pre 5/1/01		**Vesting For CAP Amounts Awarded Post 5/1/01**	
Age	**% Vested**	**Age**	**% Vested**
Under 50	0	Under 55	0
50	10	55	10
51	20	56	20
52	30	57	30
53	50	58	50
54	70	59	70
55 and up	100	60 and up	100

If an employee in the CAP leaves the NYSE prior to the vesting age, he or she receives none of his or her CAP awards, as none of the awards vest. In that case, the book entry for that employee's CAP awards are reversed and the NYSE records income on its books relating to the CAP awards because it does not have to pay out those awards.

As certain percentages of a participant's CAP awards become vested, that amount is moved into a Vanguard account (a Rabbi Trust), *i.e.*, that amount is actually funded. Through those accounts, the money is invested based on the particular employee's selection from several investment options. An employee has no access to his or her CAP awards (even once vested) while employed at the NYSE. The employee cannot borrow against the CAP account, and can collect their CAP awards only when he or she is no longer employed at the NYSE.

During his tenure at the NYSE, the total amount of Grasso's CAP awards was $21,683,333, which he was awarded between 1999 and 2002, as follows:

Year	**CAP Award**
1999	$ 3,300,000
2000	$ 6,800,000
2001	$ 8,050,000
2002	$ 3,533,333

Grasso's 1999 contract did not specifically provide for vesting and funding in accordance with the CAP schedule, but it appears that, as a practical matter, his CAP awards were in fact vested and funded pursuant to that schedule. Pursuant to his 1999 contract, Grasso would forfeit his entire CAP account – vested and unvested sums (*i.e.*, what was accrued on paper and what had been funded into his Vanguard account) – in the event that, prior to the natural end of the contract on June 1, 2005, his employment at the NYSE was involuntarily terminated for cause or he voluntarily terminated his employment without

"Good Reason," as that term is defined in the 1999 contract. Thus, under the 1999 contract, his CAP awards were not actually vested and collectible unless and until he completed the 1999 contract term.

In connection with the execution of his 2003 employment contract, Grasso received a payout of $13,218,000 of his total CAP awards. This amount represented the portion of Grasso's CAP awards that already had "vested" and had been moved to a Vanguard account. This payout was part of the $139,486,000 in deferred compensation and benefits that the NYSE paid to Grasso on or about September 2, 2003, pursuant to the 2003 employment contract. Pursuant to the 2003 contract, the remaining portion of Grasso's CAP awards, plus interest at a rate of 8% annually, vested according to the following schedule:

Vesting Date	Amount Vesting
Grasso's 57th Birthday (7/26/03)	$ 1,449,822
Grasso's 58th Birthday (7/26/04)	$ 2,950,630
Grasso's 59th Birthday (7/26/05)	$ 3,115,866
Grasso's 60th Birthday (7/26/06)	$ 4,604,921

Under Grasso's 2003 employment contract, these sums were to be paid to Grasso "as soon as practicable following the January 1st first occurring" after the vesting of each amount. These amounts, which total $12,121,239, were part of the more than $48 million in scheduled future payments of deferred compensation and benefits that Grasso was to receive under the 2003 employment contract.

(v) "Special Payments"

In 2000, and again in 2001, Grasso was awarded a "Special Payment" of $5 million.[28] In effect, these were additional bonus amounts awarded to Grasso. These bonus awards were made entirely separate and distinct from his salary and the awards he received under ICP, and were not related to LTIP or CAP. These awards were not part of any program identified in or provided by Grasso's 1999 employment contract, which was in effect at the time these amounts were awarded. Because these awards were not part of Grasso's salary or ICP, they were not SERP-eligible, *i.e.*, they did not contribute to Grasso's total SERP calculation or accumulation.

The $5 million Special Payment awarded in 2000 was not scheduled to vest until February of 2006. According to some on the Compensation Committee, the award was intended to have "hooks" in it and to serve as a retention device. Under the terms of the award, it was to earn 8% annual interest until vesting, at which time it would be transferred to Grasso's SESP account.[29] Accordingly, when the $5 million Special Payment actually would be paid to Grasso in February 2006, the total payment would be $7,347,000.

The $5 million Special Payment awarded in 2001 was placed directly in Grasso's SESP account (discussed *infra*) at the time it was granted. That $5 million, plus the interest it earned in Grasso's SESP account ($100,000), was paid out as part of the approximately $139.5 million lump-sum payment made to Grasso on or about September 2, 2003, pursuant to his 2003 employment contract.

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28 *See* NYSE 029676 -17, 023656-59, 029686-87, 023940-41, 030135-36, 046052.

29 *See* NYSE 000123-24.

(vi) Grasso's Total Compensation By Year

Grasso's compensation for each year he served as Chairman was as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
1995	$ 1,264,583*	$ 900,000	---	---	---	$ 2,164,583
1996	1,400,000	1,600,000	---	---	---	3,000,000
1997	1,400,000	3,800,000	---	---	---	5,200,000
1998	1,400,000	4,204,000	$ 396,000	---	---	6,000,000
1999	1,400,000	5,652,000	948,000	$ 3,300,000	---	**11,300,000
2000	1,400,000	12,519,000	1,081,000	6,800,000	$ 5,000,000	26,800,000
2001	1,400,000	16,100,000	---	8,050,000	5,000,000	30,550,000
2002	1,400,000	7,066,666	---	3,533,333	---	11,999,999
Total	$11,064,583	$51,841,666	$2,425,000	$21,683,333	$10,000,000	$97,014,582

Because Grasso resigned in September 2003, for 2003 he received only salary and not any ICP award, CAP award, or Special Payment.

* Note: Grasso's 1995 salary reflects five months as President and Executive Vice Chairman.

** Note: In 1999, Grasso also received a $795,667 "gross up" payment.[30] That payment stemmed from the transfer of $29,980,062 in SERP benefits from Grasso's SERP account to his SESP account. In connection with that transaction, it was calculated that Grasso would be required to pay Medicare taxes in the amount of $795,667. The Compensation Committee awarded Grasso a "gross up" in that amount so that, from Grasso's perspective, the transaction would be tax-neutral.

b. Benefits

(i) Employee Savings Plan ("Savings Plan" or "401(k) Plan")

The NYSE Savings Plan is a qualified retirement savings plan commonly known as a "401(k) plan."[31] All NYSE employees are eligible to participate in the Savings Plan. Participating employees may contribute up to 25% of their base salary into their Savings Plan accounts, of which 6% is matched by the NYSE, subject to limitations under the Internal Revenue Code on the annual amount of contributions that participants may make and the amount of annual compensation that may be taken into account in computing benefits under the Savings Plan. Participants may allocate their savings across a variety of investment choices that are offered.

Grasso was a participant in the Savings Plan. As of July 2003, Grasso had accumulated approximately $2 million in his 401(k) account.

30 *See* NYSE 030204.

31 *See* NYSE 000657-752.

(ii) Supplemental Executive Savings Plan ("SESP")

The NYSE's SESP mirrors the NYSE's 401(k) plan, but is available only to NYSE employees earning more than $200,000 per year (the current salary limit under the Internal Revenue Code for 401(k) eligible contributions).[32] In January 2002, the limit on SESP contributions was changed from a floor of $150,000 to 200,000.[33]

The first $200,000 of an employee's salary is considered eligible for 401(k) contributions. For salary amounts in excess of $200,000, an employee can elect to contribute a portion of those amounts to a SESP account. As with the 401(k) plan, the NYSE matches an employee's contribution up to the first 6% of the employee's base salary that is deferred into his or her SESP account. Senior Vice Presidents and above, including Grasso, were allowed to defer amounts into their SESP accounts that were paid to them as bonuses. An employee's SESP account – containing the employee's contributions plus the NYSE's matching contributions – is a Vanguard account through which the employee invests the funds pursuant to the employee's selection of investment vehicles from various alternatives. Following an employee's termination of employment at the NYSE, the employee may elect to receive his or her account balance in a lump-sum distribution or in annual installments.

Grasso was also a participant in the SESP. For most of his tenure as Chairman and CEO, the first $150,000 of Grasso's base salary was eligible for the NYSE 401(k) plan, while the remaining $1.25 million was eligible for the SESP. As of August 2003, Grasso's SESP account contained $6,368,000, which represented the total of his contributions and the NYSE's matching contributions accumulated over the years of his NYSE employment, as well as any interest those amounts had earned.

In addition, in connection with Grasso's 1999 employment contract, $29,928,062 was transferred from Grasso's SERP account (discussed *infra*) to his SESP account. As of August 2003, the amount of that transfer, plus interest earned in the SESP account on that amount, stood at $33,608,000. Also, the $5 million Special Payment Grasso was awarded for 2001 was placed directly into his SESP account. As of August 2003, that payment, with interest earned, had grown to $5,100,000. These three SESP amounts – $6,368,000; $33,608,000; and $5,100,000 – were transferred to Grasso's personal Vanguard account on or about September 2, 2003, as part of the $139,486,000 lump sum payment made to Grasso pursuant to his 2003 employment contract.[34]

(iii) NYSE Retirement Plan

The NYSE Retirement Plan (the "Retirement Plan") is a fully funded, ERISA qualified, noncontributory, defined benefit plan that applies to all NYSE employees.[35] Benefits under the Retirement Plan are based on a set percentage of the participant's base salary for each year of service, subject to certain alternative calculations. Since 1989, the percentage has been 2.35%. The amount of annual compensation (base salary, excluding bonuses) that may be considered in calculating benefits under the Retirement Plan is limited by the Internal Revenue Code. Presently, that limit is $200,000.

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32 *See* NYSE 000515-82.

33 *See* NYSE 000536-37.

34 *See* NYSE 029897-99, 29911-15.

35 *See* NYSE 000755-876.

The Retirement Plan benefit is payable as an annuity following retirement. Full benefits can be collected after retirement at age 60, and an employee cannot collect anything prior to age 55. Between ages 55 and 60, a retired employee wishing to collect his Retirement Plan benefits will be able to collect subject to certain early retirement penalties. Specifically, there is a built-in 2% penalty each year prior to age 60. Grasso participated in the Retirement Plan. As of August 2003, Grasso accrued an annual Retirement Plan benefit of approximately $110,625, which he could begin to collect at age 60, after retirement.

(iv) Supplemental Executive Retirement Plan ("SERP")

The NYSE SERP is a non-qualified, defined benefit retirement plan that was created in 1984 and was designed to supplement the NYSE's qualified pension plan.[36] To participate in the SERP, an employee's annual salary was required to be above a certain threshold. At present, that threshold is approximately $166,000. (The threshold is adjusted yearly based on average salaries at the NYSE.) There are approximately 50-60 current NYSE employees who qualify for and participate in the SERP, as well as retirees who are presently collecting SERP benefits accumulated while working for the NYSE.

Grasso participated in the SERP from its inception in 1984 until he became President and Executive Vice Chairman in 1990. As of that time, Grasso no longer participated in the SERP, but he received a contractual SERP-like benefit. The contractual SERP-like benefit was built into Grasso's 1990, 1995 and 1999 employment contracts, and largely mirrored the SERP benefits provided to the NYSE employees who participated in the SERP.

Under the SERP (and Grasso's contractual SERP-like benefit), upon retirement after age 55, the employee receives SERP benefits. The employee's SERP benefits are not vested until the employee reaches age 55 while still employed at the NYSE. If a SERP participant leaves the NYSE prior to age 55, his or her SERP benefits never become vested and are forfeited in their entirety. An employee's SERP benefits are fully vested at age 60. An employee who retires after age 55, but before age 60, will receive SERP benefits reduced by 2% per year for each year retired prior to age 60. Thus, if an employee retires at age 58, he or she receives 96% of his or her SERP benefits.

If the employee is eligible to receive SERP benefits at retirement, the employee can elect to receive the SERP benefits in the form of either: (1) a lifetime annuity; or (2) a one-time lump sum payment in the amount of the present value of the annuity at the time of retirement. The lump sum payment option was implemented in 1997, in conjunction with other plan measures. An employee has no access to his or her SERP benefit prior to retirement.

During the time that an employee participating in the SERP is still employed at the NYSE (*i.e.*, prior to the employee's retirement), the employee's accumulation of SERP benefits is an accounting entry; the SERP benefits are not funded. The NYSE maintains a Rabbi Trust that supports the SERP, but the trust is empty. An employee's "accumulated SERP benefits" at any point in time is the present value of the SERP benefits that would be due to the employee upon retirement.

The SERP utilizes a different formula for defining benefits than the formula used under the Retirement Plan. The benefit paid under the SERP is defined by two factors: (1) the employee's final average pay; and (2) the employee's total years of service at the NYSE, which determines the percentage of the employee's final average pay that the employee is eligible to receive as a SERP annuity benefit.

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[36] *See* NYSE 000877-921, 000583-98.

An employee's final average pay consists of the average of the highest consecutive three years of the employee's pay during his last ten years of service at the NYSE. "Pay" for employees beneath Senior Vice President level is defined only as salary. For Senior Vice Presidents and above, including Grasso, "pay" also included ICP awards.

The percentage of final average pay that is used to determine an employee's SERP annuity benefit is based on the employee's years of service. For the first ten years of the employee's service, the employee's SERP annuity benefit is equal to 25% of the employee's final average pay. After twenty years of service, the employee's SERP annuity benefit is equal to 45% of the employee's final average pay. After thirty years of service, the employee's SERP annuity benefit is equal to 60% of the employee's final average pay. For each year of service after thirty years, the percentage of the employee's final average pay that is used to compute the employee's SERP annuity benefit is increased by 1%. Prior to 1997, there was a cap on the number of service years that could be used in determining the employee's SERP benefits: 35 years. In 1997, however, that restriction was removed, in conjunction with other plan adjustments.

To compute SERP benefits to which a SERP participant is entitled upon retirement, the following formula is employed:

Obtaining the SERP Annuity Benefit:

(1) Calculate the employee's final average pay, which is comprised of the average of the employee's three highest consecutive years of pay (salary and ICP awards, but not CAP or LTIP or "special payments") within the last ten years of the employee's retirement.

(2) Calculate the applicable percentage of the employee's final average pay, based on the employee's years of service, that will be used to determine the level of the SERP annuity benefit. The percentage is equal to the sum of: 2.5% for each of the first 10 years of service, plus 2% for each of the next 10 years of service, plus 1.5% for each of the next 10 years of service, plus 1% for each year of service thereafter. For example, if an employee has 30 years of service when he retires (after age 55), the employee's SERP benefit equals 60% of his final average pay; if the employee has 41 years of service at the time of retirement, his SERP benefit equals 71% of his final average pay.

The resulting sum (from steps (1) and (2)) constitutes the employee's Base SERP Benefit.

(3) Multiply the Base SERP Benefit by a percentage based on the participant's age. At age 60, the percentage is 100%; at age 59, it is 98%; at age 58, it is 96%; at age 57, it is 94%; at age 56, it is 92%; and at age 55, it is 90%.

(4) Subtract the employee's annual pension amount under the Retirement Plan.

(5) Subtract the employee's annual Social Security payment.

The resulting sum is the employee's SERP Annuity Total, *i.e.*, the amount the employee shall receive per year in SERP benefits, from retirement until death. By way of example, if an employee retired at age 60 after thirty years of service at the NYSE, and the employee's final average pay was $10 million at the time of retirement, the SERP benefit would be 60% of $10 million, or $6 million, with some relatively minor adjustments. The participant would be entitled to that benefit for life, or could elect upon retirement to receive the SERP benefit in a lump sum.

Obtaining the SERP Lump-Sum Benefit

The lump-sum SERP benefit that an employee is eligible to receive (since 1997) is determined by calculating the present value of the SERP Annuity Total using: (a) a mortality table (used to estimate how long the employee is likely to live) and (b) an appropriate interest rate, which is applied to determine the present value of the lifetime SERP annuity. Any lump-sum amounts previously paid out to the employee from the employee's SERP account would be deducted from the lump-sum SERP benefit that the employee would receive upon retirement.

As noted above, on several occasions during his tenure as Chairman and CEO Grasso received lump-sum payments of his accumulated contractual SERP-like benefits. Grasso also agreed on various occasions to certain adjustments as to how his SERP would accumulate and be computed.

First, in June 1995, pursuant to his 1995 employment contract, Grasso received a cash payout of his SERP benefits in the amount of $6,571,397, which represented the present value of his accumulated SERP benefits as of that date. At the time, Grasso was forty-eight years old and was still employed at the NYSE.

In May 1999, pursuant to his 1999 employment contract, Grasso was allowed to transfer $29,928,062 from his SERP book entry account to his SESP account. That money was placed in a Vanguard "Rabbi Trust" where it was funded and could be invested.

Also in connection with his 1999 employment contract, Grasso agreed with the NYSE that, for purposes of the calculation of his SERP benefits, he would be credited with an additional four years of service at the NYSE, provided he did not leave the NYSE for a non-Retirement Reason (as defined in the 1999 contract) prior to the end of the contract term on June 1, 2005. Specifically, his SERP benefit was to be calculated using a service time of whichever was greater, 41 years or his actual service.

In connection with Grasso's 1999 employment contract (and corresponding SERP-to-SESP transfer of over $29.9 million), Grasso agreed that, on a going-forward basis as of May 31, 1999, all SERP calculations performed subsequent to that date for him would account for and subtract (offset) the sum of $41,688,423. That amount represents the aggregate of the following: (1) the $6,571,397 in SERP benefits paid out to Grasso pursuant to his 1995 employment contract; (2) the $29,928,062 in SERP benefits transferred into Grasso's SESP account pursuant to his 1999 employment contract; and (3) approximately $5,188,964, which reflected the effect of the NYSE changing the mortality table with respect to benefits accrued through May 31, 1999, under Grasso's 1995 employment contract.

Also pursuant to Grasso's 1999 employment contract, the interest rate used to convert Grasso's SERP benefit to a lump sum was capped at 4%, provided that he worked through the end of his contract term,

June 1, 2005, or terminated his employment at the NYSE for a "Retirement Reason" as that term is defined in his contract.

On August 30, 2001, Grasso and the NYSE agreed to an amendment to his 1999 employment contract that affected his SERP. Specifically, Grasso and the NYSE agreed that only 85% of Grasso's annual ICP awards (as opposed to 100%, as in the past and as with other participants) was to be deemed SERP-eligible (in addition to his salary).

Finally, pursuant to Grasso's 2003 employment contract, in September 2003, the sum of about $51.6 million – the amount of liability that was accrued by the NYSE on its balance sheet as of December 31, 2002 with respect to Grasso's SERP benefits – was paid out to Grasso. Also pursuant to his 2003 employment contract, Grasso was to receive SERP benefits of approximately $28,552,000, to be paid in annual installments of $7.138 million on January 1 of 2004, 2005, 2006 and 2007, respectively, and had the right to receive other potential SERP payments when his service at the NYSE ended, depending on the circumstances of the termination of his service.

Thus, as a result of the 2003 contract and his prior contracts, by September 2003 Grasso had received payouts from his SERP account totaling $88,073,459 and had an additional $28,552,000 in scheduled SERP payments due to him over four years. In addition, pursuant to the contract terms, Grasso also possibly could have received additional amounts of SERP benefits depending on the facts and circumstances of the termination of his employment at the NYSE.

According to our expert's analysis, by August 7, 2003 (prior to the execution of his 2003 employment contract), Grasso had an accumulated SERP benefit with a present value of over $126 million. Specifically, by that time, he already had been paid out $6,571,397 in SERP benefits in 1995 and, accounting for interest on that amount at a rate of 5% from 1995 through 2003, that amount had a present value in August 2003 of about $9,918,202. He also had received a SERP-to-SESP transfer in 1999 of $29,928,062 and, by August 2003, that amount had grown to $33,608,000 via investments made through his SESP account. Finally, between May 1999 and August 2003, he had accumulated an additional $82,571,150 in SERP. Thus, on August 7, 2003, the present value of the amount of SERP benefits Grasso had accumulated was about $126,386,529.

(v) Other Benefits

In addition to the benefits conferred to Grasso pursuant to the above-referenced benefits programs, he also enjoyed a variety of additional benefits while he was Chairman and CEO. Among those were life insurance, disability insurance, vacation, a car/driver, various club memberships, security and use of a private plane.[37]

[37] *See* NYSE 000096-99, 029929-39, 030287-90.

(vi) Total Accumulated (Retirement) Benefits as of August 7, 2003

As of August 7, 2003, the approximate present value of Grasso's accumulated benefits was as follows:

401(k):	approximately $2 million
SESP:	$6,368,000
Retirement Plan:	$110,625 per year
SERP	$126,386,529[38]

B. Process By Which Grasso's Annual Compensation Was Determined During His Tenure as Chairman and CEO of the NYSE

1. Overview of Annual NYSE Compensation Process as to Grasso

Grasso's total compensation for each year he was Chairman and CEO was determined in and around February of the following year. The determination of Grasso's final compensation level was made at the same time as, and in connection with, the annual compensation process employed by the Compensation Committee for all NYSE employees, but Grasso's compensation was given separate consideration by the Compensation Committee and the Board.

The process for determining Grasso's compensation involved three basic steps. First, the Human Resources Department, working with the Compensation Committee's compensation consultants, would pull together certain materials for the Compensation Committee to consider in making its compensation decisions for Grasso and other NYSE employees. Although the precise nature of these materials varied from year to year, as a general matter these materials included information about Grasso's past compensation, information about the level of performance of the NYSE and its employees, and information about the compensation levels of the market or peer group against which the Committee would benchmark Grasso's compensation. As a general matter, this material would be either provided to or discussed with the Committee members individually prior to the Compensation Committee meeting in February, so that the Committee members had the opportunity to review and consider the materials in advance of the February Committee meeting.

Second, the Compensation Committee would then hold its February meeting. As part of this meeting, the Committee would consider and evaluate presentations from the Human Resources Department and Grasso regarding the performance of the NYSE and other matters relevant to compensation. The Committee would also consider and discuss, without Grasso present, Grasso's compensation, and would reach an accord on the amount of compensation that it would recommend that the Board award to Grasso.

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[38] *See* Johnson Report, Ex. 3. This present value SERP benefit is the amount of SERP benefits to which Grasso would have been entitled under his 1999 contract had he resigned voluntarily, without "good reason," as defined in the 1999 contract, on August 7, 2003. If he was terminated for cause or left for "good reason" on August 7, 2003, the present value of the SERP benefit to which he was entitled on that day, pursuant to his 1999 contract, would be substantially higher. As noted above, this computation of the lump-sum present value of Grasso's SERP benefit as of August 7, 2003 takes into account that Grasso already had received a SERP payout of $6,571,397 in 1995 and a SERP-to-SESP transfer of $29,928,062 in 1999. With interest on these amounts properly considered, the $6,571,397 paid out in 1995 has a present value of about $9,918,202 (assuming an interest rate of 5%), and the $29,928,062 transferred into Grasso's SESP account in 1999 grew to $33,608,000 by August 2003.

Third, after the Committee meeting, the February Board meeting would be held. At that meeting, the Committee Chairman would make a relatively brief presentation regarding the Committee's recommendations to the Board on specific compensation issues, including the compensation that should be awarded to Grasso. The Board would then vote on the matters recommended by the Committee, including the compensation level for Grasso.

Each of these steps in Grasso's compensation process is discussed in further detail *infra*.

2. Sources of Information for the Compensation Committee

Generally, the information considered by the Compensation Committee in making compensation decisions for Grasso came from the Human Resources Department and the Committee's consultants.

a. NYSE Human Resources Department

The Human Resources Department provided to the Committee, on an annual basis, various information in connection with the Committee's February meeting, at which compensation determinations were made for the prior year.

In the first couple years of Grasso's tenure as Chairman and CEO (1995-1997), Joseph P. Johnson headed up the Human Resources Department and was the main person responsible for coordinating and providing information to the Compensation Committee. In 1997, however, Johnson retired and, after that, Frank Z. Ashen, who before Johnson retired had been next in line under Johnson in the Human Resources Department management structure, took over the responsibility of coordinating the information for the Committee.

Ashen was Executive Vice President, Corporate Services, and acted as the head of the Human Resources Department for most of Grasso's tenure, from 1997 through 2003; he retired from the NYSE shortly after Grasso resigned in September 2003. Beginning even before Johnson retired, and continuing through the end of Grasso's tenure as Chairman and CEO, Ashen was the central link between the NYSE staff, Grasso, the Compensation Committee, and the Committee's consultants on compensation matters. He often worked closely with the Committee Chairman and the consultants. He was assisted in these responsibilities by Dale B. Bernstein, who was next in line under Ashen in the Human Resources management structure while Ashen was the head of the department and who since Ashen retired has taken over Ashen's position as the head of the Human Resources Department.

The information that Ashen and his staff provided to the Committee generally included information concerning Grasso's prior compensation level, compensation levels of other NYSE employees, and the performance of the NYSE, as reflected by the NYSE's ICP performance evaluation process. Ashen also coordinated with the consultants to gather market or peer group data that the Committee used to benchmark Grasso's compensation, and compiled that data in various forms for the Committee's review. Ashen created benchmarking sheets that were provided to the Committee for evaluating Grasso's compensation. In addition, Ashen from time to time provided other materials that the Committee requested.

b. Compensation Consultants

The Committee's longtime outside consultant on compensation matters was Hewitt Associates LLC ("Hewitt"). Hewitt worked with the NYSE Compensation Committee throughout Grasso's tenure as Chairman and CEO. Jeffrey S. Hyman was the Hewitt consultant who worked with the Committee since 1996.

Hyman regularly attended the yearly meetings of the Compensation Committee in February, at which compensation decisions were made for the prior year, and also attended various other Committee meetings from time to time, including the Committee meetings each fall when ICP targets were discussed and set for the upcoming year. On a yearly basis, Hyman also provided Ashen, for use by the Committee, market information concerning the compensation levels of the comparator group used by the Committee to benchmark Grasso's compensation. Hyman was involved in the creation of various compensation programs adopted by the Committee, including the LTIP and the CAP, and provided information about a variety of issues including the composition of the comparator group.

As discussed more fully *infra*, while it is clear that Hewitt performed the foregoing functions for the Committee, the information we received in the Investigation regarding the precise scope of Hewitt's responsibilities is somewhat in conflict. Several Committee members expressed the view that the Committee looked to Hewitt, and specifically to Hyman, for overall guidance and advice on compensation issues, including benchmarking. Hyman, however, claimed that he served the role of simply providing information to the Committee and asserted that he was not asked to provide, and did not provide, any specific advice on what the level of Grasso's compensation should be, or other key aspects of the compensation process, such as what the composition of the comparator group used by the Committee should be or what should be the precise formula by which benchmarking was performed by the Committee.[39]

3. Information Considered by the Compensation Committee in Determining Grasso's Annual Compensation

Compensation Committee members generally agreed that there were three primary considerations that they evaluated each year in making decisions regarding Grasso's compensation: (1) Grasso's prior compensation levels; (2) the performance of the NYSE and Grasso; and (3) the compensation levels of the market or peer group against which the Compensation Committee would benchmark Grasso's compensation.

a. Prior Grasso Compensation Levels

Each year, the Human Resources Department provided information to the Committee concerning Grasso's past compensation levels. However, the information provided to the Committee concerning Grasso's past compensation usually related to only the prior year, and sometimes the prior two years.

[39] In addition to Hewitt, the Committee also used the services of another consultant, Mercer Human Resource Consulting ("Mercer"), but not for annual compensation decisions. Since at least the early 1980s, Mercer provided actuarial services and performed related tasks for the Committee and NYSE's Human Resources Department relating to benefits, including in the area of pension benefits. William Mischell is the consultant at Mercer who worked with the Committee and the Human Resources Department in these areas since about mid-1985. Mercer's role was restricted to advice on actuarial, pension-related matters and did not involve providing any advice or services concerning the Compensation Committee's annual decisions regarding compensation of NYSE employees, including Grasso.

Although many of the Committee members stayed the same from year to year, often the Committee also had some new members each year, so not all Committee members were provided with full knowledge of all of Grasso's past annual compensation levels, or necessarily understood the full progression of his compensation levels over his tenure as Chairman. Indeed, the majority of Committee members were on the Committee for only a few years at a time, and did not receive information about the full progression of Grasso's compensation levels over the course of his tenure as Chairman.

b. Performance of the NYSE

The performance of the NYSE was one of the main factors the Compensation Committee considered in evaluating the compensation level appropriate for Grasso each year. In gauging the performance of the NYSE, the Committee relied almost exclusively on the evaluation of the NYSE's performance that was conducted each year in connection with the ICP. A written summary of the ICP performance evaluation was provided to the Committee each year prior to the February Committee meeting at which compensation decisions were made.[40]

A summary of this performance evaluation also was presented by Grasso and Ashen to the Committee orally at the February Committee meeting. Committee members relied heavily on the annual ICP performance evaluations in determining whether Grasso had performed well as Chairman and CEO.

(i) ICP Performance Evaluation Process Generally

During Grasso's tenure, there were two main components of the ICP performance analysis: objective (or what Grasso referred to as "empirical") performance factors, which represented 65% of the overall performance determination, and the Chairman's Award, which was Grasso's subjective performance determination of the performance of the NYSE and represented 35% of the overall performance determination.

The objective or empirical performance criteria, and target levels for those criteria, were determined at the outset of each year by the Compensation Committee, based on the analysis and recommendation of Grasso, Ashen, and their staff. At the end of the year, the Committee then evaluated how the NYSE had performed measured against the target levels set for each of the empirical performance criteria. In addition, the Committee considered the subjective performance evaluation of the NYSE made by Grasso (the Chairman's Award) and reached an overall decision as to the performance of the NYSE. The Committee then took into account the overall ICP performance evaluation in making its compensation determinations, including its compensation determinations for Grasso.

(ii) Objective or Empirical Performance Criteria

The objective or empirical performance criteria were set each year by management, with approval of the Compensation Committee. Each year, usually in about December, Grasso and other top NYSE executives, including Johnston, Kinney, and Britz, would evaluate and make a decision as to what the empirical performance should be for the coming year, what weight should be given to each of those criteria in the overall performance evaluation measurement (*i.e.*, how much of the 65% each of the criteria accounted for), and what the target levels should be for each of those measurements. In making these

[40] *See* NYSE 035339-57, 036387-445, 033405-37, 031325-52, 033352-76, 033327-51, 033531-62, 046087-111.

determinations, Grasso and senior management considered information provided to them by others in management, and analyzed the goals and strategy of the NYSE for the coming year.

After Grasso and his other top executives made their conclusions as to the appropriate nature, weights, and target levels for the empirical performance criteria, Grasso and Ashen would present to the Compensation Committee their recommendations as to each of those matters. At the February Committee meeting, the Committee would then vote on the recommendations. Typically, the Committee approved the recommendations without any adjustments, although on a few occasions some minor adjustments were made.

Generally, during the years of Grasso's tenure as Chairman and CEO, the empirical performance criteria, and the weights assigned to them, remained substantially the same. The main empirical performance criteria during these years included the following:

(1) Financial Performance of the NYSE: Typically, this factor judged the financial performance of the NYSE by the level of expenses of the NYSE and the NYSE's pretax profits.

(2) Equity Market Share: This factor assessed the NYSE's market share of trading, *i.e.*, the percentage of trades that were completed through the NYSE as opposed to through other means or methods.

(3) Listing Penetration: This factor assessed the NYSE's ability to obtain new listings of companies on the NYSE, either by companies transferring from other exchanges or by listing anew through initial placement offerings (IPOs).

(4) Regulatory Performance: This factor judged the NYSE's regulatory performance on such things as the speed of resolution of the NYSE's regulatory cases.

From 1995 through 1997, each of these four empirical performance factors was weighted roughly equally, with the 65% being divided up as 15% for financial performance, 15% for equity market share, 18% for listing penetration and 17% for regulatory performance. In subsequent years during Grasso's tenure as Chairman and CEO, the financial performance factor comprised only 10% and the equity market share factor comprised only 5%, while the listing penetration and regulatory performance categories were largely replaced by new categories focusing on goals of the NYSE's various divisions.

According to Grasso, Ashen and the Committee members, the goal in establishing the empirical criteria for the ICP performance evaluation, and in assessing weights to each of them and target levels for each of them, was to come up with a performance measurement that would best reflect the NYSE's performance. Grasso, Ashen and the Committee members stated they believed that, each year, the ICP performance evaluation succeeded in identifying measures that accomplished that goal. They stated that they felt that the criteria used were accurate gauges of the Exchange's performance and were fair, accurate, and complete. They indicated that nothing was missing from the ICP empirical criteria employed for judging the overall performance of the NYSE. Likewise, all of the directors we interviewed who provided information in this area concurred that the empirical criteria were the right criteria to use to judge the performance of the NYSE and that no significant factors were missing from the criteria.

The target levels for each of the empirical criteria changed each year. To set the target levels, each year each operating division of the NYSE performed an analysis of its anticipated performance. The division heads then provided their respective analyses to senior management and Grasso, who would make the final decisions on the target levels for all of the empirical performance criteria. According to Grasso, the target level of performance for each of the empirical criteria (*i.e.*, achieving 100% performance for that criteria) was designed to create a "stretch" that required above-average performance to attain. Grasso described the targets as intended to be attainable but demonstrative of success in the face of competition.

During Grasso's tenure as Chairman and CEO, the NYSE's performance against the targets on the empirical performance criteria was significantly above 100%, *i.e.*, well above the total target 65 performance points on the empirical criteria. The performance on the empirical criteria is reflected in the following chart.

SUMMARY OF NYSE TARGET/ACTUAL PERFORMANCE ON EMPIRICAL ICP PERFORMANCE CRITERIA, 1995-2002
(In "Performance Points")

Year	Financial Performance		Equity Market Share		Listing Penetration/Non-regulatory Divisional Performance*		Regulatory Performance**		Total		% of Target
	Target	Actual	Target	Actual	Target	Actual	Target	Actual	Target	Actual	
1995	15	23	15	8	18	30	17	21	65	82	126
1996	15	16.51	15	12.45	18	30.02	17	17.26	65	76.24	117
1997	15	21.15	15	24.45	18	25.35	17	22.5	65	93.45	144
1998	12	19.78	16	16.67	21	18.15	16	20.97	65	75.57	116
1999	10	16.58	15	7.16	32	38.27	8	10.94	65	72.95	112
2000	10	18.53	10	9	37	54.03	8	11.85	65	93.41	144
2001	10	16.78	5	7	40	52.05	10	13.55	65	89.38	138
2002	10	15.85	5	0	30	35.15	20	23.84	65	74.84	115
Avg.	12.13	18.52	12	10.59	26.75	35.38	14.13	17.74	65	82.23	127

* From 1999 forward, the NYSE eliminated the Listing Penetration and Regulatory Performance categories and introduced a category made up of several divisional goals. The divisions included Equity Group, Competitive Position, International Group, Regulatory Group, and Other Organizations. In 2002, these divisions were condensed to include Equity Group/International, Competitive Position/Regulation, and Other Organizations. Thus, in this chart, from 1999 to 2001 the columns for Listing Penetration become columns for the combined performance of Equity Group, Competitive Position, International Group, and Other Organizations. In 2002, the columns reflect combined performance of Equity Group/International and Other Organizations.

** As stated above, from 1999 onward, the NYSE eliminated the Listing Penetration and Regulatory Performance categories and introduced a category made up of several divisional goals. These divisions included a Regulatory Group. In 2002, the Regulatory Group subcategory was combined with Competitive Position. Thus, for the purposes of this chart, from 1999-2001 the columns for Regulatory Performance reflect the performance of the Regulatory Group, and in 2001 the columns reflect the performance of Competitive Position/Regulatory Group.

(iii) Chairman's Award

The Chairman's Award component of the ICP performance analysis was designed to measure the performance of the NYSE on various intangible or non-numerical criteria. According to Grasso, it was intended to add "a dimension beyond the quantitative" to the performance analysis. This piece of the ICP performance analysis was essentially a subjective judgment by Grasso regarding the NYSE's performance on a variety of matters.

The factors considered under the Chairman's Award changed from year to year, and were not easily convertible into numerical measurements. Grasso stated that consideration of these additional factors was necessary to get a complete picture of NYSE's performance in a given year. Directors generally agreed that these measures provided a measurement of the intangible factors that demonstrated the overall performance of the NYSE beyond just the numerical criteria, and that the addition of these factors in the overall performance evaluation of the NYSE made the performance evaluation process complete, *i.e.*, that no significant elements or considerations were missing from the performance evaluation process.

Throughout Grasso's tenure as Chairman and CEO, the Chairman's Award comprised 35% of the ICP performance criteria; thus, the target level of the Chairman's Award was always 35%, or 35 performance points. Grasso explained that, as with the empirical measurements, 100% of the target of the Chairman's Award (35 performance points) was meant to be "a stretch" requiring above-average performance. He noted that "extraordinary" would be higher than 100% performance.

Grasso was solely responsible for the final determination of the Chairman's Award. Grasso said that, in determining the amount of the Chairman's Award each year, he examined the results of the ICP empirical criteria and looked at the total ICP performance points earned against the targets. He said that he then "backed into" the number for the Chairman's Award by making a determination of the overall ICP award that was appropriate for the year and then subtracting the amount of performance points earned under the empirical criteria. For example, in 2000, the Chairman's Award was 62. Grasso determined this number by determining that a total ICP award of 155 would be appropriate and subtracting the amount of the objective or empirical performance award, which was 93.

As was the case with the empirical performance criteria, the Chairman's Awards during Grasso's tenure exceeded 100% of the target (35 points) each year. The Chairman's Awards Grasso granted are reflected on the following chart.

SUMMARY OF NYSE TARGET/ACTUAL PERFORMANCE, CHAIRMAN'S AWARD, 1995-2002 (In "Performance Points")

Year	Chairman's Award		
	Target	Actual	% of Target
1995	35	48	137
1996	35	58.76	168
1997	35	51.55	147
1998	35	54.43	156
1999	35	47.05	134
2000	35	61.59	176
2001	35	65.62	187
2002	35	40.16	115
Average	35	53.40	153

(iv) Accuracy/Validity of Annual ICP Performance Determinations

Grasso stated that, in his view, the annual ICP performance evaluations produced an accurate and fair indication of the NYSE's overall performance each year. Grasso said he felt comfortable that awards each year accurately reflected the NYSE's performance. He said he did not feel that the performance levels were inflated or overstated, or that they were understated. He stated that the mere fact that the numbers exceeded the targets each year did not raise a red flag or concern with him that perhaps the targets for the empirical criteria had been set too low, or that his Chairman's Awards were too high. He believed the targets were set appropriately and fairly to gauge performance, and that performance exceeded the target expectations each year.

Grasso stated that neither Ashen, the Committee, the Board, nor anyone else suggested (or asked whether) the targets for the empirical criteria were too low or his Chairman's Awards were too high. He said that the issue of the targets possibly being set too low, or anyone questioning the setting of the targets, never came up at any management or staff meeting, Compensation Committee meeting, or the Board meeting at which he was present. He noted that each year he had presented his recommended total ICP award to both the Committee and the Board, and no one ever questioned whether he was being too generous. He said he also did not recall anyone ever questioning whether he was being too harsh.

However, some Compensation Committee members recalled that, from time to time, questions were raised in Committee meetings about whether the target levels were set too low or were too easy to achieve. Some Committee members recalled that these questions were raised in light of the consistently high performance against targets, and that it was questioned at Committee meetings whether achieving 135% of performance on average each year was realistic or accurately reflected the true performance of the NYSE.

Notably, each year during Grasso's tenure as Chairman, the percentage amount by which the Chairman's Award exceeded the target was substantially more than the percentage amount by which the performance on the empirical criteria exceeded their targets. As a result, the Chairman's Award had the effect each year of driving up the overall performance evaluation number under the ICP. This effect is shown in the following chart.

SUMMARY OF NYSE TARGET/ACTUAL PERFORMANCE, OVERALL ICP EVALUATION, 1995-2002 (In "Performance Points")

Year	Chairman's Award			Performance Based on Empirical Criteria			Total ICP Performance Evaluation	
	Target	Actual	% of Target	Target	Actual	% of Target	Target	% of Target
1995	35	48	137	65	82	126	100	130
1996	35	58.76	168	65	76.24	117	100	135
1997	35	51.55	147	65	93.45	144	100	145
1998	35	54.43	156	65	75.57	116	100	130
1999	35	47.05	134	65	72.95	112	100	120
2000	35	61.59	176	65	93.41	144	100	155
2001	35	65.62	187	65	89.38	138	100	155
2002	35	40.16	115	65	74.84	115	100	115
Average	35	53.40	153	65	82.23	127	100	135.63

Grasso acknowledged that he knew that each year the percentage above target that he awarded in the Chairman's Award was above the percentage above target reflected in the empirical performance criteria. He acknowledged he knew that, as a result, the Chairman's Award would increase the overall ICP performance evaluation, which in turn would increase the ICP awards. He also acknowledged that he knew that the Committee considered the performance of the NYSE in evaluating his own compensation, and that the Committee used the ICP evaluation process as a method to evaluate his performance.

However, Grasso stated that he did not manipulate or set the Chairman's Award or the target levels of the empirical criteria so as to increase, without proper foundation, the ICP evaluation or to increase his own compensation. He said that, each year, in his view, the target levels of the empirical performance criteria were set appropriately, and the additional intangible factors he considered in the performance of the NYSE under the Chairman's Award justified higher percentage awards against the target in the Chairman's Award than those awarded in the empirical criteria.

(v) Performance of Grasso Apart from ICP Performance Evaluation Process

Most Compensation Committee members stated that their view was that Grasso's performance evaluation should be closely tied to the performance evaluation of the NYSE. They agreed that, as Chairman and CEO, Grasso should take the credit when the NYSE performed well, and should shoulder the blame if the NYSE performed poorly. They thus relied heavily on the evaluation of the performance of the NYSE, determined by the NYSE's ICP performance evaluation process, as reflective of Grasso's overall performance.

Some Committee members also said that, in addition to relying on the performance of the NYSE to evaluate Grasso's performance, they also received information about Grasso's performance level from their general exposure to the NYSE, including through discussions with persons at the NYSE and in the industry. These directors said that, through the information they gathered from these sources, they concluded that Grasso was performing very well as a CEO and that he was a large part of the reason behind the success that the NYSE enjoyed during Grasso's tenure.

c. Market Information/Peer Group Data

When making decisions regarding Grasso's compensation each year, the Compensation Committee not only considered information about Grasso's past compensation and the performance of the NYSE and Grasso, it also evaluated market data or peer group information. This data was used to create a benchmark for Grasso's compensation.

In connection with its gathering market or peer group compensation date, the Committee developed a "comparator group" of companies as to which it obtained compensation data concerning the companies' top executives. The Committee used the median level – or, in some years, the target median level – of compensation of the CEOs of those comparator group companies as a starting point for the benchmarks it employed in making its compensation decisions for Grasso.

(l) The Comparator Group

The Compensation Committee's use of a comparator group for benchmarking compensation dates back to before Grasso's tenure as Chairman and CEO.[41]

In 1995 and 1996, shortly after Grasso's tenure had begun, the Committee, in connection with its consideration (and ultimate implementation) of the LTIP, decided to perform an analysis of whether compensation levels of top executives at the NYSE were competitive with the market. A critical step in this process was to define what the appropriate market, or peer group, was for comparing the compensation levels of NYSE executives. The Committee, with Hewitt's assistance, thus conducted an analysis to attempt to determine the appropriate comparator group of companies against which to benchmark NYSE executives' compensation.

Over the course of several meetings in 1995 and 1996, the Committee, with input from Hewitt, discussed and debated the issue of the composition of the comparator group. During these discussions, the Committee agreed that it did not want to pay, nor should it pay, NYSE executives at levels commensurate with what investment bankers and others were making on Wall Street. The Committee also decided that the comparator group should not be too heavily weighted toward industrial organizations, the securities industry, or companies listed on the NYSE.

At one point, the Committee also decided that other exchanges should be included in the comparator group. However, for reasons that remain unclear, the Committee did not follow through on that decision and, ultimately, no other exchanges were ever included in the comparator group. Also, the Committee never seriously considered the option of comparing the compensation of the NYSE's executives to that of executives at other not-for-profit companies.

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[41] Although our Investigation generally was limited to the time frame that Grasso was Chairman and CEO (1995-2003), a Hewitt analysis dated October 2, 2003, which reviewed the history of the NYSE comparator groups, reflected that, in 1993, the comparator group employed by the Committee included the following companies:

Aetna	CBS	Fannie Mae	Paine Webber
American Express	Chase Manhattan	Freddie Mac	Sallie Mae
A.G. Edwards	Citigroup	General Electric	Salomon Brothers
AIG	Chemical Bank	Merrill Lynch	

Because the Investigation generally did not cover the period prior to 1995, the Investigation did not reveal the precise manner in which the comparator group was selected or used pre 1995. *See* NYSE 032162-69.

One point of debate in the Committee's discussions about the comparator group was whether the comparator group should be weighted to include a good number of companies in the financial services industry. While some Committee members favored this approach, other Committee members thought that including a number of companies in the financial services industry would tend to skew the comparator group numbers too high. One Committee member felt that the Committee should focus more on traditional factors in selecting a comparator group, like size of the organization, revenues, and other such characteristics, and that the Committee should select companies for the comparator group that were comparable to the NYSE in those areas. Another Committee member expressed his fear that, if there was a boom in the stock market in the future, then using a comparator group heavily weighted in the financial services industry would result in creating benchmarks for NYSE compensation that were much too high.

However, one of the Committee members concerned about using a comparator group heavily weighted in the financial services industry left the Committee before the debate on this issue was resolved, and another who felt the same way ultimately ceded this point for a number of reasons, including that the compensation levels of NYSE executives at the time were reasonable and he did not believe that the newly formed comparator group would have an immediate impact in driving up compensation of NYSE executives to unreasonable levels.

Ultimately, the Committee directed Hewitt to generate a list of potential comparator group companies for the Committee to consider, with the group being heavily weighted to the financial services industry. Hewitt did so. In suggesting companies for the Committee to consider, Hewitt selected companies from a proprietary database it maintained containing compensation information on executives at a variety of companies who participate in the database. In providing compensation consulting services to its clients, Hewitt uses that database, including as a source of comparator group compensation information, which Hewitt provides to its clients in an aggregate manner or by other means designed to maintain the proprietary and confidential nature of the database information.

At the time, Hewitt suggested various companies for potential inclusion in an NYSE comparator group in 1995, Hewitt's database included over 100 financial service organizations. Based on the Committee's direction to weight the comparator group list towards companies in the financial services industry, Hewitt selected as potential companies to include in the comparator group a set of companies in its database from three major areas: banking, insurance, and other financial services. The Committee engaged in a discussion regarding which of those companies should be in the comparator group, and whittled down the list to those companies that it felt belonged on the list.

Ultimately, the Committee selected the comparator group. While Hewitt provided input and offered suggested companies for inclusion in the formation of the comparator group, in the end, the Committee decided the precise composition of the group.

As noted above, the Committee's deliberation and selection of the appropriate comparator group in 1995-96 was part of its analysis of whether the compensation levels of top NYSE executives were adequate. Thus, in connection with selecting the comparator group at that time, the Committee evaluated the compensation levels of the NYSE's top executives against executives at the companies in the comparator group. Through that analysis, the Committee determined that the compensation levels of the NYSE's top executives, including Grasso, were not up to par with the executives in the companies in that group. Therefore, the Committee, again working with Hewitt, developed the LTIP program to make up for the perceived shortfall in the compensation levels of the NYSE executives when compared against the compensation of executives in comparator group companies.

In designing the LTIP program for the Committee, Hewitt acknowledged that the comparator group that the Committee selected ignored the conventional factors that are used to develop an appropriate comparator group. This was discussed with, and presented in writing to, the Committee. In a written overview of the LTIP that Hewitt prepared and was shared with the Compensation Committee in April 1996, Hewitt advised, "The benchmarks companies use to establish pay comparisons usually incorporate a consideration of peer company financials. Often there is a relationship between organization size and executive pay levels."[42] Hewitt set forth data showing the vast differences in the size and financials of the comparator group companies compared against the NYSE, and explained that these factors had been ignored in selecting the peer group due to the Committee's directive to "attract and retain world class executive talent" and the judgment that compensating NYSE executives commensurate with the peer group selected was required to attract and retain such talent.

When the LTIP was adopted in 1996, it incorporated the comparator group that the Compensation Committee had selected. Subsequently, the Committee began using the same, or essentially the same, comparator group in making its yearly compensation decisions each February, including its compensation decisions for Grasso. The comparator group was used each year as the foundation for determining benchmarks for compensation levels for Grasso and other top NYSE executives. Over the years that Grasso was Chairman and CEO, the comparator group developed by the Committee in 1995-96 continued to be used in that fashion and changed very little. The following charts reflect the composition of the comparator group used by the Committee from year to year. Text in ~~strikethrough~~ indicates a deletion from the prior year.[43]

1995

Bankers Trust	Wells Fargo	Allstate
Chemical Bank	American Express	Chubb Corp.
Citicorp	Freddie Mac	GEICO Corp.
The Equitable	Fannie Mae	Aetna Life
Federal Home Loan Bank	GE Capital	AIG
Fleet Financial	GMAC	CIGNA
Mellon Bank	Merrill Lynch	

1996

Bankers Trust	Wells Fargo	Allstate
Chase Manhattan Bank(Chemical)	American Express	Chubb Corp.
Citicorp	Freddie Mac	GEICO Corp.
The Equitable	Fannie Mae	Aetna Life
Federal Home Loan Bank	GE Capital	AIG
Fleet Financial	GMAC	CIGNA
Mellon Bank	Merrill Lynch	

[42] Hewitt's Discussion of Long-Term Compensation, New York Stock Exchange April 1996 (NYSE 051738-49).

[43] *See* NYSE 035282, 036427, 054211, 012248, 012657, 011511, 011203, 013140. A number of the companies in the comparator group merged with other companies. For example, in 1996, Chemical Bank merged with Chase Manhattan Bank. In 1998, Citicorp merged with Travelers Group Inc. and the new company operates under the name, Citigroup Inc. In 1999, Fleet Financial merged with BankBoston Corporation and began doing business under the name, FleetBoston Financial.

1997

Bankers Trust	Wells Fargo	Allstate
Chase Manhattan Bank	American Express	Chubb Corp.
Citicorp	Freddie Mac	GEICO Corp.
The Equitable	Fannie Mae	Aetna Life
Federal Home Loan Bank	GE Capital	AIG
Fleet Financial	GMAC	CIGNA
Mellon Bank	Merrill Lynch	

1998

~~Bankers Trust~~	Wells Fargo	Allstate
~~Chase Manhattan Bank~~	American Express	Chubb Corp.
Citicorp	Freddie Mac	~~GEICO Corp.~~
The Equitable	Fannie Mae	Aetna Corp.
Federal Home Loan Bank	GE Capital	AIG
Fleet Financial	GMAC	CIGNA
Mellon Bank	Merrill Lynch	

1999

	Wells Fargo	Allstate
	American Express	Chubb Corp.
Citicorp	Freddie Mac	
The Equitable	Fannie Mae	Aetna Corp.
Federal Home Loan Bank	GE Capital	AIG
Fleet Financial	GMAC	CIGNA
Mellon Bank	Merrill Lynch	

2000

	Wells Fargo	Allstate
	American Express	Chubb Corp.
Citigroup (Citicorp)	Freddie Mac	
AXA Financial (Equitable)	Fannie Mae	Aetna Inc.
Federal Home Loan Bank	GE Capital	AIG
FleetBoston Financial	GMAC	CIGNA
Mellon Financial	Merrill Lynch	

2001

	Wells Fargo	Allstate
	American Express	Chubb Corp.
Citigroup	Freddie Mac	
~~AXA Financial~~	Fannie Mae	Aetna Inc.
Federal Home Loan Bank	GE Capital	AIG
FleetBoston Financial	GMAC	CIGNA
Mellon Financial	Merrill Lynch	

2002

	Wells Fargo	Allstate
	American Express	Chubb Corp.
Citigroup	Freddie Mac	
	Fannie Mae	Aetna Inc.
Federal Home Loan Bank	GE Capital	AIG
FleetBoston Financial	GMAC	CIGNA
Mellon Financial	Merrill Lynch	

A number of the Committee members from the 1995-96 period who adopted the comparator group in connection with the LTIP specifically pointed out that they did not intend the comparator group to be frozen over time or rigidly applied in future years without reflection. They stated they expected that the composition of the group would be monitored and adjusted as necessary over time, depending on market conditions and other factors. These Committee members stated that one of the important considerations in selecting the comparator group in 1995-96 was that it produced reasonable benchmarks for compensation at that time. They stated that, had the comparator group in later years begun producing benchmarks that clearly were unreasonable based on other criteria and information, they would have ignored those benchmarks or awarded compensation levels substantially less than the benchmarks if that was what was required to stay within a reasonable range of compensation. When shown Grasso's compensation levels for later years (1999-2002), these Committee members agreed that such levels were too high and said that, if applying the comparator group had resulted in those levels of compensation as benchmarks, they would not have continued to employ the comparator group but instead would have modified it in some way.

According to Ashen, since its adoption in 1995-96, the comparator group was reaffirmed each year by the Compensation Committee in connection with its February Committee meetings at which compensation for the prior year was determined. Ashen said that, each year, the Committee reaffirmed its philosophy of compensating in order to attract and retain world class executives, and specifically affirmed the makeup of the comparator group. Ashen said that the Committee was specifically aware of, and made conscious decisions to ignore, the kind of factors that ordinarily go into determining a comparator group, such as revenues, number of employees, and other similar characteristics.

Ashen said that he reviewed the comparator group with Committee members at various points in time including in training sessions with him when they joined the Committee, in individual meetings he had with Committee members prior to the February Committee meetings, and at the February Committee meetings each year. Ashen stated that he also explained the history of the formation of the comparator group to new Committee members in their orientations, including how the group was formed and why it was formed in that way.

Few Committee members we interviewed recalled having discussions with Ashen about the composition of the comparator group, either in training sessions or at individual meetings with Ashen prior to the February Committee meetings. Some Committee members also had little recollection about any substantial discussions at the February Committee meetings about the composition of the comparator group. Particularly as to later years during Grasso's tenure as Chairman and CEO, many Committee members said they felt that the comparator group had been used for years and, therefore, simply did not question it, and that it was not given much thought or analysis on a yearly basis.

However, a number of other Committee members recalled active discussions at Committee meetings regarding the composition of the comparator group. In addition, the materials the Committee reviewed at the February Committee meetings, including the ICP performance evaluation summaries, contained a document showing the makeup of the comparator group.

According to the Committee members who recalled discussions about the comparator group at Committee meetings, at times there was "healthy debate" concerning the composition of the comparator group, with some questioning whether Grasso should be judged against CEOs of the comparator group companies. One factor in these discussions likely was that some Committee members had the impression that the comparator group had been formulated by Hewitt and recommended by Hewitt to the Committee, and these Committee members indicated that they deferred to what they believed to be Hewitt's judgment on this issue. Ultimately, as the comparator group largely did not change over the years, these discussions always were resolved with those having questions about the comparator group ultimately bowing to those who felt that the group was appropriate.

Notably, from 1995-96 through 2002, neither Hewitt nor any other consultant was asked by the Committee or NYSE staff to do any study or analysis regarding the composition of the comparator group, and Hewitt never suggested that such a study be done or conducted any analysis of the comparator group. However, in February 2003, the Committee expressed its intention to review the makeup of the comparator group and asked Hewitt to conduct such an analysis and, if appropriate, make recommendations for changes to the group.[44]

Pursuant to its assignment, in October 2003, Hewitt provided the NYSE a document entitled "Revisiting the Compensation Peer Group–A Reconsideration of Benchmark Standards."[45] The document has two sections: (1) "A History of the Peer Group Selection," which provides an overview of the formation and composition of the NYSE's comparator group over the years; and (2) "Alternatives for the Future," which sets forth various potential alternative comparator groups that could be used by the NYSE.

In the "Alternatives" section, the Hewitt report sets forth six alternative comparator groups that the NYSE could consider. These alternatives include comparator groups comprised of (1) NYSE listed companies; (2) service companies; (3) financial services companies; (4) chartered oversight companies and other exchanges; (5) private companies; and (6) companies with similar employee count. Hewitt's report provided median compensation data for 2002 for the CEO-level positions at each of these potential comparator groups. This data shows that the comparator group used by the Compensation Committee produced a substantially higher benchmark for Grasso's pay than any of the alternatives set forth in Hewitt's report.

Specifically, the Committee's comparator group produced a target median compensation level of $13,449,200 to be used as a starting benchmark for Grasso's 2002 compensation.[46] The alternative comparator groups in the Hewitt report produce the following median compensation levels which could have been used to benchmark Grasso's 2002 compensation:

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44 *See* NYSE 032162-69.

45 *See* NYSE 053862-71.

46 *See* NYSE 053928, 052946-61.

Alternative Comparator Group	Median Level CEO Benchmark
NYSE listed companies	$ 4,889,500
Service companies	$ 5,264,200
Financial services companies	$ 4,866,500
Chartered companies & other exchanges	$ 8,477,700
Private companies	$ 2,452,000

Thus, the Committee's comparator group produced a starting benchmark for Grasso's 2002 compensation ($13,449,200) that exceeded the benchmarks produced by Hewitt's alternative comparator groups by roughly $11 million (448% increase) to $5 million (59% increase). Interestingly, as far back as March 1998, Hewitt had provided NYSE Vice President of Human Resources Dale Bernstein, who worked closely with Ashen on executive compensation matters, information regarding the compensation of CEOs of two similar groups – federally chartered organizations and information services companies.[47] Thus, even at that time, Hewitt was providing information suggesting that Grasso's compensation could be compared to these types of organizations.

During the Investigation, many of the Committee members we interviewed stated that they believed that the comparator group used by the Committee to benchmark Grasso's compensation was appropriate and justified. Some other Committee members acknowledged that there were problems with the composition of the comparator group and believed that perhaps it should have been adjusted.

In contrast, the majority of Board members we interviewed who were never on the Committee believe that the comparator group used by the Committee was not appropriate. These Board members never saw the comparator group used by the Committee and were never made aware of it until recently. Many of them expressed strong sentiments that the comparator group employed by the Committee was not an appropriate comparison or benchmark for Grasso's pay due to a variety of factors, including the disparity in size and complexity of the comparator group companies and the NYSE, and the NYSE's nature as a not-for-profit company.

(ii) Comparator Group Data: Actual or Target Median

As part of the process of devising a benchmark for Grasso's compensation each year, the Compensation Committee obtained information from Hewitt regarding the compensation levels of CEOs in the comparator group used by the Committee. The Committee also received similar comparator group information regarding other top NYSE executives for benchmarking their compensation. The Committee received this information prior to and in connection with the February Committee meetings at which yearly compensation decisions were made.

The specific information that the Compensation Committee received regarding the comparator group compensation levels changed over time. In most years (for compensation decisions for the years 1995-2000), the Committee was provided the actual median level of compensation of the CEOs (and other top executives) in the comparator group companies. In this context, the "median" compensation level of a CEO, for example, means the compensation level of the CEO in the comparator group that is higher than half of the compensation levels of the CEOs in the comparator group and lower than the other half of the compensation levels of CEOs in the group.

[47] *See* NYSE 052305-07.

In later years (for compensation decisions relating to the years 2001 and 2002), the Compensation Committee was provided the "target median" of the comparator group instead of the actual median of that group. The target median was based on information in the Hewitt database concerning the target compensation level for executives in the comparator group for that year.

Whether provided in the form of an actual median or a target median, the comparator group compensation information that Hewitt provided to Ashen, and Ashen provided to the Committee, included the comparator group total cash compensation, including salary, bonus and stock options, which were valued on a Black-Scholes basis.[48] Thus, the actual or target median comparator group compensation level that formed the starting point for the Committee's benchmarking of Grasso's compensation included the long-term or equity-based components of the comparator group's compensation.

The actual or target median compensation levels of the comparator group that Hewitt provided Ashen and his staff each year were based on actual compensation data from the prior year. For example, information Hewitt provided Ashen in February 2000 about the comparator group's median 1999 compensation was based on the actual median compensation level of comparator group CEOs for 1998. The reason for this data lag is that, in February of each year, Hewitt would not yet have received all of the information about the comparator group companies' compensation awards for 1999.

In at least some of the years during Grasso's tenure as Chairman and CEO, Ashen received comparator group information from Hewitt that was more detailed than just the actual median or target median compensation levels that Ashen provided to the Committee. Specifically, at times Ashen would receive both target median and actual median data, but provided only the actual median information. In other years, Ashen received a broader range of information from Hewitt on the comparator group compensation levels, such as the high, low, 25th percentile, 75th percentile, 90th percentile and/or the average of the comparator group's executives' actual and/or target compensation levels.[49] However, Ashen did not share this broader information with the Committee, but instead provided the Committee only the actual or target median level, which the Committee used to create a benchmark for compensation decisions.

(iii) Other "Market" Information

Some Compensation Committee members we interviewed stated that, in addition to considering the comparator group median compensation levels provided to them by Ashen and Hewitt as part of the benchmarking process, they also considered other information about "the market." These directors stated that the "market" to which they were referring was the stock market and/or the compensation levels of Wall Street executives and executives in the business community generally, both of which they viewed as being to some extent tied to the stock market.

These directors were not relying on any precise information or specific data about the overall levels of compensation on Wall Street or the business community, but instead were relying on: (1) their knowledge of the compensation levels of various other executives on Wall Street or in the business

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[48] The Black-Scholes Model is the most widely used model for estimating the present value of stock options granted by a company to its employees. In 1973, Fischer Black and Myron Scholes developed the formula at the University of Chicago. It includes consideration of option price, price of the underlying security, stock price volatility, risk free rate of return, dividend yield, and expected term of the option grant. *See* Bruce R. Ellig, The Complete Guide to Executive Compensation, McGraw Hill (2002), at p. 374.

[49] *See, e.g.*, NYSE 052464-96, NYSE 052441-48, NYSE 052427-28, NYSE 053155-56, NYSE 052946-61.

community as a whole; and (2) their general sense, based on their experience and general knowledge and involvement with Wall Street and the business community, that those compensation levels generally rose or fell with the performance of the stock market.

The Committee members who said they relied on this other "market" information said that, as a general matter, their view was that Grasso's level of compensation should rise or fall to some extent with the market. Thus, they believed that when the market was booming or doing well, compensation levels of executives on Wall Street or generally in the business community were up, and Grasso's compensation level should follow suit, whereas if the stock market was down, compensation for Grasso and other top executives should also drop.

d. Benchmarking Grasso's Compensation

Each year, the Compensation Committee used the comparator group information it received to benchmark the compensation of Grasso and other top NYSE executives. The method by which the Committee used the comparator group information to create the benchmark for Grasso changed over the course of Grasso's tenure as Chairman and CEO.

(i) Benchmarking for Compensation Years 1995-1998

During the period from February 1996 through February 1999 (covering compensation decisions for the years 1995 through 1998), the benchmark the Committee used for Grasso's compensation was simply the actual median level of compensation of the comparator group (based on the prior year's compensation awards to the comparator group). The Committee used that actual median level as a benchmark for its discussions and determination as to what the appropriate level of compensation for Grasso should be.[50]

(ii) Benchmarking for Compensation Years 1999-2000

In February 2000 and February 2001 (for compensation for the years 1999 and 2000), the Committee still used the actual median compensation level of the comparator group as the starting point for creating a benchmark for Grasso's compensation, but Ashen, in creating a benchmark for the Committee, incorporated several other steps in the benchmarking process.[51] Specifically, to generate a final benchmark for Grasso's compensation, Ashen applied a formula incorporating three new steps:

Step One: Ashen reduced the actual median compensation level of the comparator group by one-third. According to Ashen, he made this reduction to attempt to take out of the comparator group median compensation level the amount of that compensation that was attributable to the performance of the comparator group's executives. Ashen said that he received information from Hewitt that the actual performance level of the comparator group was 150%, for both 2000 and 2001. (Hewitt's Jeff Hyman said that he did not recall providing such information to Ashen, but that such information was in Hewitt's data base and that it was possible he could have provided it to Ashen.) Ashen said that he therefore reduced the actual median compensation level of the comparator group by one-third so as to achieve a "100%" level for the comparator group, *i.e.*, a comparator group median without the comparator group's actual performance level taken into account.

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50 *See* NYSE 036646-48, 036411, 038068-69, 038110, 039398, 012343.

51 *See* NYSE 054142, 054064.

Step Two: After performing the above calculation, Ashen further reduced the comparator group actual median by a discount factor. This discount factor was 10% for the comparator group median applicable to Grasso and 30% for the comparator group medians applicable to Johnston, Kinney, and Britz. Ashen performed this reduction pursuant to the direction of the Compensation Committee.

In various discussions about the comparator group in and around 1999, the Committee determined that the comparator group was not a perfect match to the NYSE, and specifically noted that the NYSE was not nearly as complex or large as the comparator group companies. Therefore, beginning in February 2000 (for 1999 compensation), the Committee decided to apply the 10% and 30% discounts to the applicable comparator group medians in an effort to account (at least in part) for the disparity in complexity and size between the comparator group and the NYSE.[52]

According to Ashen and several Committee members, the reason the Committee decided to apply a larger discount (30%) for Johnston, Kinney and Britz than the discount it applied for Grasso (10%) was that the Committee determined that the positions and job responsibilities of Johnston, Kinney and Britz at the NYSE were substantially different from those of the comparator group executives to whom they were being compared, whereas Grasso's position as Chairman and CEO more closely paralleled the position and responsibilities of the other CEOs and Chairmen in the comparator group.

Step Three: Ashen multiplied the adjusted (step one above) and discounted (step two above) median compensation level of the comparator group by the final ICP performance determination for the year being considered. Ashen performed this calculation in order to take the actual performance level of the NYSE into account for the Committee, in benchmarking the compensation of Grasso, Johnston, Kinney and Britz.

Thus, for 1999 compensation (decided in February 2000), the formula Ashen employed to benchmark Grasso's compensation for the Committee worked as follows: (1) obtain from Hewitt the comparator group actual median CEO compensation level ($9,700,000); (2) reduce the actual median by one-third to take out the performance of the comparator group CEOs, producing adjusted median of $6,466,667; (3) discount the adjusted median by 10%, producing a discounted adjusted median of $5,820,000; and (4) multiply the discounted, adjusted median by 120%, which represented the NYSE's performance against targets as determined by the ICP performance evaluation process.[53] This formula produced an overall benchmark for Grasso of $6,984,000 for 1999 compensation. (Grasso ultimately was awarded total compensation for that year in the amount of $11,300,000.)

(iii) Benchmarking for Compensation Years 2001-2002

In February 2002 and 2003 (for compensation for the years 2001 and 2002), Ashen applied a different benchmarking formula than he had used in the prior two years. Instead of starting off the benchmarking computation with the actual median of the comparator group and then reducing that actual median by the performance achieved by the comparator group (step one above), Ashen started the benchmarking with the target median of the comparator group and then eliminated step one. Ashen indicated that he did this so as to compare the NYSE executives' compensation to the target compensation of the comparator group. He said he felt that starting with the target median was the same as starting with the actual median and eliminating from that the comparator group's actual performance, as he had done in prior years.

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52 *See* NYSE 052946-61.

53 *See* NYSE 012727.

For compensation years 2001 and 2002, Ashen continued to apply the last two steps of the formula that he had used in the prior two years. Specifically, after starting with the target median, he then reduced the target median by 10% for Grasso and multiplied that discounted target median by the final ICP performance determination for the year being considered. Thus, for compensation for 2001, Ashen began with a target median compensation level of $13,349,864 and discounted that number by 10%, producing a discounted target median of $12,014,878. Ashen then multiplied the discounted median target number by the performance of the NYSE as determined by its ICP performance evaluation process (155% against target for 2001). This produced a final benchmark for Grasso's compensation of $18,623,061.[54] (Grasso was awarded total compensation for that year in the amount of $30,550,000.)

e. Other Information/Considerations

(i) Retention of Grasso

Some Committee members stated that, in connection with their compensation decisions, they considered the NYSE's need to retain Grasso as Chairman and CEO. They said they viewed Grasso as a top performer who was responsible for the success of the NYSE and saw it as a potential risk that Grasso might leave the NYSE for another position. They stated that they wanted to ensure that Grasso was sufficiently compensated to provide him with incentive to remain at the NYSE. These Committee members did not articulate any specific other employment opportunities that Grasso was presented with or was considered for during his tenure, or any substantiation for a concern that Grasso may leave the NYSE other than a general fear that Grasso may be an attractive prospect for other organizations.[55]

Grasso, who had been employed at the NYSE virtually his entire adult life, said that he often told directors and others that he loved his job and had no intention of leaving the NYSE. He said that he never mentioned to any directors that he had other job opportunities, discussed any such opportunities with them, or in any way threatened or suggested that he might leave the NYSE. Many directors likewise stated that they never took seriously the notion that Grasso might leave the NYSE. These directors said they dismissed as without foundation the argument a few other directors made at times that the need to retain Grasso, or the possibility that Grasso might leave the NYSE, should be a factor considered in reaching compensation decisions regarding Grasso.

(ii) Equity Component for Grasso

Some Committee members stated that, in assessing Grasso's level of compensation, they believed it was appropriate to provide Grasso with an equity type component to his compensation, similar to the stock options provided to top executives at public companies. They viewed this type of compensation to be important to retain Grasso and keep him content with his compensation at the NYSE so that he would continue to be motivated to perform well. Other directors we interviewed stated that they did not think it was appropriate to evaluate Grasso's compensation in whole or in part on the equity component of the compensation of executives at large financial companies, in part because of the difference between the NYSE and those companies and the risk involved with the equity component of those executives' compensation.

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54 *See* NYSE 011201, 053980.

55 As discussed *infra*, some Committee members said that, in about the summer of 2002, Grasso was mentioned as a potential candidate for the Secretary of the Treasury. However, he said he made it clear to the Compensation Committee, including through discussions with Langone, that he was not interested in that job, or any other job.

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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57 *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 Bernstein.

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 main 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.

Gault noted that, in the end, for 1995 the Committee decided to award Grasso $200,000 over his target bonus because the Committee also gave Grasso's predecessor, William Donaldson, an additional parting bonus of $200,000 that year. The Committee figured that, because Donaldson received an additional $200,000 bonus for the first six months of 1995, Grasso deserved an additional $200,000 bonus for the last six months of that year. Gault said that, while Grasso's bonus was above the target for 1995 due to Donaldson's compensation, Gault did not anticipate that Grasso necessarily would receive a bonus over and above his target bonus in future years.

Gault characterized Grasso's 1995 compensation as "very fair and acceptable" and not "overly generous," in the Committee's view. Although other Committee members did not have as strong a recollection as Gault concerning the precise manner in which Grasso's ICP bonus was determined that year, several other Committee members at that time stated they too believed that Grasso's 1995 compensation award was reasonable.

Grasso's total compensation awarded that year was as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
1995	$1,264,583	$900,000	---	---	---	$2,164,583

(b) February 1997 (1996 Compensation)

Directors on the Committee in February 1997, at which time Grasso's 1996 compensation was determined, did not have strong recollections about the process by which they made their decision on Grasso's 1996 compensation. However, documents reflect that Grasso was awarded compensation below the median target of the comparator group used by the Committee.

Specifically, documents reflect that, in December 1996, Hewitt provided both target and actual median numbers of CEOs of the comparator group, which were as follows:[58]

	Median Target	Median Actual
Base	$ 850,000	$ 850,000
Annual Incentive	689,000	1,575,000
Long-Term Incentive	1,534,000	1,534,000
Total	3,433,000	4,263,000

Hewitt then prepared a worksheet contained in the ICP material for 1996 which provided, regarding Grasso, as follows:[59]

[58] *See* NYSE 052036-38, 036324-25.

[59] *See* NYSE 036411.

	Comparator Median Target	Recommended Actual
Base	$ 850,000	$1,400,000
Annual Incentive	689,000	1,600,000
Long-Term Incentive	1,534,000	---
Total	3,433,000	3,000,000

Prepared notes for Ralph S. Larsen, the Committee Chairman at the time of the February 1997 Committee meeting, reflect that the Committee's objective was to compensate Grasso "based on total compensation of comparator group of companies and performance."[60] Performance of the NYSE was at 135% of target this year.

Larsen's notes state that the recommendation for Grasso was as outlined in the worksheet prepared by Hewitt: a base salary of $1,400,000, an ICP award of $1,600,000, and a total of $3,000,000. Ultimately, Grasso was awarded total compensation for 1996 as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
1996	$1,400,000	$1,600,000	---	---	---	$3,000,000

(c) February 1998 (1997 Compensation)

As with compensation for 1996, Committee members did not have strong recollections regarding the discussions that occurred at the February 1998 meeting regarding Grasso's compensation for 1997. Documents, however, again show that Grasso was compensated at a level roughly commensurate with the median comparator group levels.

In advance of the February 1998 Committee meeting, Hewitt sent Dale Bernstein of the NYSE's Human Resources department market information showing that the median target compensation for CEOs in the comparator group was $4,799,500, and that the median actual compensation was $5,245,950.[61] Hewitt also provided information indicating that the 60th percentile of the comparator group had a target compensation level of $6,882,853, and that the 75th percentile had a target compensation level of $8,461,960 and an actual compensation level of $11,155,000.[62]

The executive compensation worksheet prepared for the meeting set forth the following information:[63]

	Comparator Target	Recommended Target
Base	$ 900,000	$ 1,400,000
Annual Incentive	1,980,000	3,400,000
Long-Term Incentive	2,519,615	---
Total	4,799,500[64]	4,800,000

60 *See* NYSE 036332-33.

61 *See* NYSE 052464-96, 052427-30, 052441-48.

62 *See* NYSE 052441-48, 052429-30.

63 *See* NYSE 038110.

64 As in original.

At the meeting, Grasso reported that the NYSE's performance under the ICP performance evaluation was 145% of target. According to a memo to file written by Jeff Hyman of Hewitt after the meeting,[65] because Ashen spoke to each Committee member individually before the meeting about the ICP performance evaluation, "formal approval was perfunctory" concerning the performance level attained by the NYSE.

However, according to Hyman's memo, approval of 1997 bonuses was a more controversial process because one Committee member (who was not named in the memo) challenged the bonuses for Group Executive Vice Presidents based on the feeling that comparable talent could be purchased in the market for less money. He reported that this lone dissenter also argued that senior management joined the Exchange understanding the absence of equity. Hyman suggested, "Looking forward to 1998 . . . it is likely we will need to be conservative in pay increases since the mix of components for the Exchange executives is more risk adverse than it is in the outside market, while, at the same time, total compensation levels are getting closer to the external standards."

Hyman's memo further stated that discussion of pay for Grasso was "surprisingly heated." He noted that Larsen, the Committee Chair, had requested that information with respect to 60th percentile pay practices be disseminated to all Committee members and that this pay level would have meant a compensation award of $6.8 million. He described one group as advocating the market median for Grasso (total pay of $4.8 million) and one member advocating the 60th percentile pay of $6.8 million. The memo states: "Several other members felt a $5 million number would be more than adequate, and there was a fair amount of debate around the issue." According to the memo, "most of the concern centered on the sheer magnitude of the award given the Chairman's role (not a public company), its relative worth in relation to 1997 pay, and a concern about 'raising the bar' on Grasso's pay in general." Hyman's memo reports that, ultimately, $5.2 million in total compensation was approved for Grasso. The memo states: "In approving this package, the Committee stressed the need to ensure true variability in total compensation, and to ensure total pay suffers traumatically in poor performance years."

Ultimately, Grasso's total compensation for 1997 was as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
1997	$1,400,000	$3,800,000	—	—	—	$5,200,000

(d) February 1999 (1998 Compensation)

Committee members did not have strong recollections regarding the specific discussions at the February 1999 Committee meeting at which Grasso's 1998 compensation was determined. Documents show that, prior to the meeting this year, Jeff Hyman of Hewitt and Dale Bernstein discussed the possibility of applying a 10% discount to the median comparator group compensation levels when benchmarking Grasso's compensation "to reflect historic Comp. Committee opinion of position value."[66] However, the discount was not applied until the following year.

[65] *See* NYSE 052317-18.

[66] *See* NYSE 052685-86.

Hewitt created worksheets showing a target median compensation level for the comparator group CEOs of $5,772,998 and an actual median compensation level of those CEOs $6,419,030.[67] Ashen and Bernstein then created an executive compensation worksheet relating to Grasso showing a median compensation level for the comparator group CEOs as $6,419,030.[68]

The worksheet for Grasso also compared Grasso's position relative to the comparator group the prior year to what his position would be for compensation for 1998. Specifically, the worksheet showed that Grasso was compensated at the median ($5.2 million) in the prior year based on 145% performance of the NYSE against targets that year, and suggested that, if 145% of target would translate into the median ($6,419,030) compensation level for 1998, then the actual performance of the NYSE in 1998 (130%) translates into a benchmark for Grasso's 1998 compensation of $5,754,992.

Ultimately, the Committee decided to award compensation in the amount of $6 million, which was slightly below the median and slightly above the benchmark that was created. The Committee then "backed into" the amount of the LTIP and ICP that would be awarded, in conjunction with Grasso's fixed salary under his contract, to provide a total award of $6 million. Grasso's compensation for 1998 was specifically as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
1998	$1,400,000	$4,204,000	$ 396,000	---	---	$6,000,000

(e) February 2000 (1999 Compensation)

In advance of the February 2000 Committee meeting, Hewitt provided Dale Bernstein actual and target median compensation levels for the comparator group. Specifically, Hewitt provided the following information regarding the actual and target median levels of CEOs in the comparator group:[69]

	Median Target	Median Actual
Base	$ 992,200	$ 992,200
Annual Incentive	1,025,000	2,002,500
Long-Term Incentive	5,331,250	5,331,250
Total	8,469,155	9,723,450

Based on this information, Ashen then created an executive worksheet for Grasso using the actual median compensation level of the CEOs in the comparator group.[70] In crafting the worksheet, Ashen applied the benchmarking formula that he began using this year: he reduced the actual median by one-third to account for (and exclude the impact of) the performance of the comparator group CEOs, resulting in an adjusted median of $6,466,667. He then discounted the median by 10%, to $5,820,000. Finally, he multiplied the adjusted, discounted median by the NYSE's performance against its targets for that year, under the ICP performance evaluation, which was 120%. This produced a benchmark for Grasso's compensation of $6,984,000.

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67 *See* NYSE 052719-20, 032627.

68 *See* NYSE 012343.

69 *See* NYSE 052940-45.

70 *See* NYSE 012727.

As discussed above, a number of Committee members generally recall the benchmarking formula that was applied, while others did not recall any such formula. Some recalled the 10% discount against the median being implemented in about 1999, and recalled that the discount was applied based on the Committee's determination that the NYSE was smaller in size and less complex than the comparator group companies. Other Committee members did not recall the discount being applied.

No Committee members had a recollection of any specific discussions about Grasso's compensation award during the February 2000 Committee meeting. All generally recalled that there was discussion generally, but none had a recollection of any particular positions taken or points made except that Grasso had performed very well. Most agreed that there was not any significant debate or argument about the level of compensation to award to Grasso, and that the Committee generally reached an amicable consensus that the amount awarded was appropriate.

Some said that they did not recall discussing the CAP amount, but instead thought that the Committee focused on only the non-CAP aspect of Grasso's compensation and, in doing so, decided to award Grasso a total of $8 million, up $2 million from the year total the year before. The worksheet that Ashen prepared did not include CAP on the chart of Grasso's compensation, and listed the "total variable compensation" as $6 million. However, the effect of the total variable compensation award on Grasso's CAP was set forth underneath the compensation chart in the worksheet, as follows: "In 1999 Mr. Grasso will receive 50% of his variable compensation in the Capital Accumulation Plan."

Ultimately, the Committee awarded Grasso total compensation for 1999 as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
1999	$1,400,000	$5,652,000	$ 948,000	$3,300,000	---	$11,300,000

(f) February 2001 (2000 Compensation)

In December 2000, in anticipation of the February 2001 Committee meeting, Hewitt provided Dale Bernstein both actual and target median compensation information for the comparator group:[71] The comparator group information regarding CEOs was as follows:

	Median Target	Median Actual
Base	$ 1,018,964	$ 1,018,964
Annual Incentive	2,564,086	2,565,625
Long-Term Incentive	6,886,522	6,886,522
Total	11,924,016	11,922,548

Based on that information, Ashen prepared an executive compensation worksheet for Grasso that was provided to the Committee.[72] On the worksheet. Ashen used the actual median from the comparator group ($11,923,000) to benchmark Grasso's compensation. The worksheet showed the actual median reduced by one-third, resulting in an adjusted median of $7,948,000. This adjusted median was then discounted by 10% to $7,153,295. Finally, the adjusted, discounted, actual median was multiplied by

71 *See* NYSE 052837-42.

72 *See* NYSE 054064.

various percentages representing NYSE's potential performance levels against its targets for the year. The 150% performance level produced a benchmark of $10,729,942, while the 160% performance level produced a benchmark of $11,445,272. Because the NYSE's actual performance level was 155% in 2000, the final benchmark for Grasso's compensation was $11,087,607.

The Committee decided to award a total of $26.8 million in total compensation, nearly two-and-a-half times the benchmark. Of that amount, $5 million was a "Special Payment," the first such payment that Grasso received. The Committee determined, and later memorialized in a letter to Grasso from Committee Chairman Langone, that the $5 million Special Payment would not vest until February 1, 2006, and would be forfeited if Grasso was fired for cause or resigned without "good reason," as that term was defined in his 1999 employment contract, before the natural termination of the contract.[73]

The executive compensation worksheet that Ashen prepared and provided to the Committee at the meeting listed the "total cash comp." to be awarded this year as $15 million, and did not have columns in the chart listing Grasso's CAP award of $6.8 million, his Special Payment of $5 million, or his total compensation of $26.8 million.[74] The CAP award was instead listed only underneath the chart as follows: "Mr. Grasso will also receive a capital accumulation award equal to 50% of the Variable Compensation." Ashen had another version of the same worksheet in his files, which was not provided to the Committee, that contained a column for the CAP award, listing it as $6.8 million, and a column for total compensation, listing it as $21.8 million.[75] That chart, however, also did not include the $5 million Special Payment.

When asked during the Investigation why the Committee awarded a total amount much higher than the benchmark, and why the Special Payment in particular was awarded, those present at the meeting had greatly differing recollections. Some did not recall the size of the award as being $26.8 million, and recalled significantly lesser amounts being discussed at the meeting and awarded. One Committee member stated that he recalled only a $5 million bonus being discussed and that, if he had known the total compensation was $26.8 million, he would have had "major trouble" approving that amount. Three other directors likewise stated that they had no recollection of the total amount of $26.8 million ever being discussed at the meeting.

On the other hand, Ashen and two directors recalled that the total amount of the compensation was discussed. They recalled that the general reason for the high award this year was that Grasso had done a great job, and the NYSE had been very successful. Also, they wanted to keep him happy so he would stay at the NYSE, and they wanted to compensate him for the fact that, unlike executives at large public companies, Grasso did not have any stock options. They said that the Committee decided on the overall award of $26.8 and then "backed into" the subcomponents of Grasso's total compensation such as the awards under CAP, LTIP, and ICP.

Another Committee member, who did not recall the amount being as high as $26.8 million, nevertheless said that, at the Committee meeting, there was discussion "about the compensation getting very lofty" and that directors were asking "are we getting carried away here?"

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73 *See* NYSE 011432.

74 *See* NYSE 054064.

75 *See* NYSE 011598.

As to the reason for the $5 million Special Payment, Ashen stated that he and Jeff Hyman of Hewitt advised the Committee that Grasso's SERP was getting too big and suggested that the Committee "carve out" some bonus from Grasso's ICP award so that the carved out bonus amount would not count toward Grasso's SERP calculation. While Hyman had no recollection that he or Ashen made such a suggestion, and did not recall what the reason was for the $5 million Special Payment, two of the directors agreed with Ashen that the $5 million Special Payment was a "carve out" so that Grasso's SERP benefits would not grow too large.

The minutes of the Committee meeting reflect that "The Committee stated that it was its intention to institutionalize this special award, with the amounts and vesting schedules to be agreed each year."[76] Ashen said that this was a reference to the Committee's decision that, to try to keep Grasso's SERP benefits from getting too high, the Committee each year would consider "carving out" some of Grasso's ICP bonus into a Special Payment, to keep the SERP benefits level under control. Two other directors recalled an intention to "institutionalize" such a payment, but none of the other directors interviewed had any recollection of such an intent. Ashen acknowledged that the Committee did not perform any analysis as to what amount of carve out from SERP was needed for that year, or what the effect on SERP would be from such a carve out.

In fact, four Committee members did not recall any mention of SERP or any carve out from Grasso's ICP bonus to try to keep Grasso's SERP benefits from growing too high. They had no recollection of SERP being discussed at the meeting. Likewise, Hyman had no recollection of SERP being discussed.

The total compensation awarded to Grasso for the year was as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
2000	$1,400,000	$12,519,000	$1,081,000	$6,800,000	$5,000,000	$26,800,000

(g) February 2002 (2001 Compensation)

Prior to the February 2002 Committee meeting, Hewitt provided the NYSE Human Resources Department with actual and target median data for the comparator group.[77] The information was as follows with respect to CEOs:

	Median Target	Median Actual
Base	$ 1,032,250	$ 1,032,250
Annual Incentive	2,253,187	2,679,940
Long-Term Incentive	10,174,619	10,174,619
Total	13,439,864	14,358,567

Ashen prepared an executive compensation worksheet from the information Hewitt provided, but this year used the target median of $13,349,864 as opposed to the actual median, as he had done in prior years.[78] Because he used the target median, Ashen did not reduce the median by an amount so as to excise

[76] *See* NYSE 031521.

[77] *See* NYSE 053155-56.

[78] *See* NYSE 053980.

the performance of the comparator group CFOs from the comparator group data, as he had in prior years when using the actual median.

Ashen applied the discount of 10% to the target median, producing a discounted target median of $12,014,878. The discounted target median was then multiplied by the various potential levels of NYSE performance against its targets for that year. Because the actual performance for the year was 155%, the formula produced a final benchmark of $18,623,061 for Grasso's compensation.

The Committee decided to award a total of $30.55 million in total compensation. Of that amount, $5 million was a "Special Payment," identical to the Special Payment he had been awarded the prior year. The Committee determined that the Special Payment would be payable to Grasso's SESP account and deferred until Grasso's retirement.

Ashen said that, going into the meeting, he suggested to Langone, and Langone agreed, that for this year there should be a $10 million carve out from Grasso's ICP award so that SERP would not grow so high. At Langone's direction, Ashen said, he then prepared and provided the Committee with an executive compensation worksheet that included a salary of $1.4 million, an ICP award of $10.6 million, a special award of $10.5 million, and a CAP award of $3 million, for a total award of $25.5 million.[79]

Ultimately, Grasso's total awarded compensation included a $1.4 million salary, a $16.1 million ICP award, a $8.05 million CAP award, and a $5 million Special Payment, for a total award of $30.55 million. This was reflected in a subsequent executive compensation worksheet that Ashen said was prepared after the February 2002 Committee meeting.[80]

While a number of Committee members did not recall the precise amount of compensation awarded for 2001, all recalled that the amount of compensation awarded that year was substantial. The directors said that the Committee's rationale for the large compensation for Grasso in 2001 was largely the same as the prior year – Grasso's outstanding performance throughout the year, the need to retain him and keep him content in his job, and the need to account for the fact that he did not have stock options like other Wall Street executives.

In this year, directors said, Grasso's outstanding performance (including the NYSE reaching 155% of targets for the second straight year) was achieved despite the difficult circumstances presented by the terrorist attacks on the World Trade Center on September 11, 2001, making Grasso's achievements even more remarkable. These directors were quick to point out, however, that press and media accounts reporting that Grasso was awarded a $5 million bonus "for 9/11" are untrue, as Grasso was not awarded the bonus for the events of 9/11 or simply because of his handling of those events.

One director said that the total compensation number was suggested first by Langone, as $25 million plus a $5 million special bonus. The director said that the numbers "blew him away" and that, in hindsight, he maybe should not have agreed to a compensation award that high. He said that at the time he went with the flow and did not object, as he didn't want to be the first to speak out, but if others had spoken up he might have also.

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79 *See* NYSE 053980.

80 *See* NYSE 011201.

Five of the eight Committee members had no recollection of the Special Payment being awarded so as to avoid increasing Grasso's SERP, or as a "carve out" from the ICP to avoid SERP accumulation. They said they had no recollection of SERP being discussed at that time, either in connection with the compensation awards or otherwise. They recalled no "carve out" or attempt to separate some of the bonus money outside the ICP award so that pension benefits would not grow. However, the other three Committee members and Ashen all agreed about the carve out.

According to Jeff Hyman of Hewitt, at this meeting he advised the Committee for the first time that they were paying Grasso too much. Hyman said that he was not asked for his opinion on Grasso's overall compensation level, as he had not been asked in any prior years, but that he felt compelled to say something this year. He stated that he told the Committee that "you have set the standard very high" and asked them, "What will you do for him next year?" He said that, ultimately, his objection resulted in the Committee reducing its award to Grasso by about $5 million. While other directors generally did not recall Hyman making these remarks, Ashen said his recollection was that Hyman did raise an objection.

Grasso's total compensation awarded this year was as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
2001	$1,400,000	$16,100,000	---	$8,050,000	$5,000,000	$30,550,000

(h) February 2003 (2002 Compensation)

In January 2003, Hewitt provided both the actual and target median for the compensation decisions at the February 2003 Committee meeting:[81]

	Median Target	Median Actual
Base	$ 1,032,250	$ 1,032,250
Annual Incentive	1,548,375	2,191,919
Long-Term Incentive	10,610,567	10,610,567
Total	13,449,199	13,400,355

Ashen prepared an executive compensation worksheet for Grasso for 2002 using the target median of $13,449,199.[82] He discounted the target median by 10%, to $12,104,207, and then created a chart showing the discounted target median multiplied by various potential NYSE performance levels for the year. The chart showed that, at 110% performance against its target, the benchmark for Grasso would be $13,314,628; and at 120% performance, the benchmark would be $14,525,049. Because the NYSE's actual performance against its targets for the year was 115%, Grasso's benchmark was $13,919,838.

For this year, the worksheet for the first time reflected historical compensation information for the past two years instead of just the prior year. In addition, unlike in prior years, the worksheet set forth columns listing the CAP award and the total compensation figure for the current and past two years, except for the Special Payments that had been awarded.

81 *See* NYSE 052946-61.

82 *See* NYSE 053928.

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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84 *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 non-qualified 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 SERP benefits of any employees, including Grasso, and that they were not told of Grasso's or any other employee's accumulated SERP 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 SERP benefits largely mirrored the SERP 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 SERP 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 SERP formula, the "drivers" of Grasso's SERP 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.

his SERP benefits grew. Accordingly, as Grasso's ICP awards increased each year, and particularly began to reach extremely high levels for 2000 (over $12 million) and 2001 (over $16 million), his SERP benefits accumulation skyrocketed. Between 1999 and August 2003, his SERP benefits accumulation was over $82 million.

As part of its monitoring of the NYSE's overall SERP expense, the NYSE's Human Resources Department, including Ashen and Bernstein, received yearly reports on the amount of Grasso's accumulated SERP benefits and also understood how Grasso's yearly ICP awards impacted his accumulation of SERP benefits.

For example, in January 1999, the Human Resources Department asked William Mischell of Mercer to calculate the impact on SERP expense if Grasso received a total compensation award (salary plus ICP award) of $5 million.[86] Mercer reported to Bernstein that a total compensation award in that amount would increase Grasso's lump-sum SERP accumulation from about $20 million to about $27 million (including the $6.5 million payout Grasso had already received in 1995).

Similarly, in September 2000, Bernstein received a report from Mischell indicating that Grasso's lump-sum SERP benefits had grown to about $60 million (including SERP-related payments and transfers Grasso already had received as of that date).[87]

On February 13, 2001, shortly after the Board had awarded Grasso a total compensation package for 2000 of $26.8 million, including an ICP award of over $12 million, Ashen received a report from Mischell computing the projected effects on Grasso's SERP based on various scenarios for Grasso's annual compensation. These projections showed that Grasso's SERP accumulation at that time was in the range of about $90 million, having increased dramatically as a result of the large ICP award that year.[88] The projections showed that, even if Grasso's compensation for the following year were drastically reduced to a total of $5-7 million in salary and ICP awards, Grasso's SERP accumulation still would grow to about $94-101 million.

About a month later, on March 5, 2001, Mischell provided additional calculations to try to predict the accumulation of Grasso's SERP benefits for SERP expense purposes. Mischell reported to Bernstein that, if Grasso received an ICP award for 2001 similar to the award he had just received for 2000 ($12 million), Grasso's SERP accumulation would jump to over $141 million and that, if he received a slightly higher ICP award ($13.6 million), his SERP accumulation would climb to about $152 million.[89]

The Human Resources Department, however, did not provide this information about Grasso's SERP benefits accumulation to the Compensation Committee on a yearly basis. Ashen stated that, because SERP was considered purely a "benefit," not "compensation," the SERP accumulation was omitted from the executive compensation worksheets he prepared for the Committee's review in connection with the February meetings.

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[86] *See* NYSE 029777.

[87] *See* NYSE 029766-67.

[88] *See* NYSE 029762-65.

[89] *See* NYSE 050636-40.

Many on the Committee indicated that, in connection with their annual compensation decisions each February, they would have liked to have received information about the level of Grasso's pension benefits accumulation, and that such information may have impacted their analysis of the compensation awarded to Grasso.

Virtually every Committee member we spoke to, however, acknowledged that, even though he did not know the precise level of Grasso's pension benefits accumulation, he was aware that Grasso had SERP benefits.[90] Most acknowledged that they understood, at least in a general way, that Grasso's salary and ICP awards contributed to his SERP benefits. Some further said that, although the Human Resources Department did not provide the Committee with a tally of Grasso's SERP benefits accumulation on a regular basis, or in connection with the February Committee meetings each year, the Committee could have asked for such information.

In addition, according to some Committee members and Ashen, the Committee became aware of Grasso's SERP benefits accumulation in 1999. Specifically, in connection with Grasso's 1999 employment contract, which was approved by the Committee on March 4, 1999 and signed in May 1999, Grasso received a SERP-to-SESP transfer of $29,928,062. This amount was the balance of Grasso's total SERP benefits accumulation as of that date less offsets, including the prior $6 million SERP benefits payout in 1995 and some other adjustments agreed to by Grasso.

Although Committee minutes reflect that the terms of Grasso's 1999 contract were reviewed with and approved by the Committee, only two 1999 Committee members we interviewed recalled ever hearing anything about the $29.9 million SERP-to-SESP transfer that Grasso received in connection with that contract. Those two Committee members, who recall the transfer, were on the four-person subcommittee created for the purpose of obtaining new contracts for Grasso and Johnston.

According to some Committee members and Ashen, the Committee also became aware of, and concerned about, Grasso's large SERP benefits accumulation in 2001 and 2002. Specifically, as set forth *infra*, some Committee members stated that, at the February 2001 Committee meeting, when discussing Grasso's compensation for 2001, the Committee decided to "carve out" some of Grasso's total bonus amount from his ICP award and pay it as a Special Payment so as to avoid Grasso's SERP benefits accumulating too high due to high ICP awards. These Committee members and Ashen stated that a similar "carve out" bonus was awarded in 2002 for Grasso's 2001 compensation. Thus, according to these Committee members and Ashen, by February 2001, the Committee was aware that Grasso's SERP benefits accumulation was getting high and took steps to limit its growth.

Neither in 2001, however, nor at any other time did the Committee calculate the effect of its ICP awards on Grasso's SERP benefits accumulation, ask for the tally of the accumulation, or conduct any study of whether the level of Grasso's pension benefits was consistent with the market or the comparator group it had created. Thus, Grasso's pension benefits continued to grow, based on the Committee's compensation awards to Grasso, without any monitoring of those benefits by the Committee.

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[90] One Committee member who was on the Committee for several years said he never heard that Grasso had SERP benefits, and one other Committee member could not recall. All others said they were aware that Grasso had SERP benefits.

D. The Negotiation and Execution of Grasso's Employment Contracts

During his tenure as Chairman and CEO of the NYSE, Grasso negotiated three employment agreements with the NYSE. This section sets forth the facts and circumstances surrounding each of these negotiations, beginning with Grasso's first employment agreement as Chairman and CEO, executed on May 11, 1995, and ending with his final employment agreement, executed on August 27, 2003.

1. 1995 Contract

On September 21, 1994, the Compensation Committee held a special meeting at which it was unanimously agreed that the Committee would recommend to the full Board on October 6, 1994, that Grasso be elected to succeed Donaldson, effective June 1, 1995.[91]

In connection with his election as Chairman, Grasso received a new employment contract.[92] At the time, Grasso already had an employment contract, which had been in place since 1990.[93] According to some Committee members, the Board discussed that it wanted to "lock in" Grasso under a new employment agreement to ensure that he would remain as Chairman for at least five years. Both of Grasso's predecessors, John J. Phelan and Donaldson, likewise had employment agreements when serving as Chairman and CEO of the NYSE.[94]

Negotiations regarding Grasso's 1995 employment contract were handled by Stanley Gault, who, at the time, was Chairman of the Compensation Committee. Gault had only a vague recollection of the negotiations, which occurred over eight years ago, and no other Committee members were substantively involved in the contract negotiations.

At around the time of the negotiations, Hewitt performed an analysis regarding an appropriate salary for Grasso. Hewitt recommended that Grasso receive a $1.4 million base salary and a target ICP award of $630,000. Hewitt also determined that "[p]art of Grasso's compensation should be tied to the level of success of the organization, including downside risk and upside potential," and an overall compensation range of $1,557,000 to $2,660,000 "determined by the organization at least meeting its goals and success measured by objective targets and the discretion of the Board."[95] Ultimately, Grasso's 1995 contract set his salary at $1.4 million and his target ICP award at $700,000.

In connection with the 1995 contract, Grasso was given a payout of his accumulated SERP benefits as of that time in the amount of $6,571,397.[96] Grasso stated that he asked for the payout so that he could put the money towards a house. Grasso said he believed that his contract provided him with the right to elect a payout of the SERP benefits at that time. Thus, rather than take out a loan to obtain funds for a house, Grasso sought and received early payment of retirement benefits for that purpose.

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91 *See* NYSE 000052-53.

92 *See* NYSE 002904-27.

93 *See* NYSE 002879-99.

94 *See* NYSE 030063, 030081, 030082-94.

95 *See* NYSE 000088.

96 *See* NYSE 002903.

In advance of the execution of the contract, Joseph P. Johnson, the NYSE Senior Vice President of Human Resources at the time, sent Gault an analysis of the advantages of paying Grasso's accrued lump-sum SERP benefits. The analysis concluded that paying the lump sum in 1995 created no additional cost to the NYSE; reduced Grasso's projected lump-sum payment in 2000; accelerated the corporate tax deduction and locked it in; protected against lower-than-expected investment returns on working capital; and allowed the NYSE to reduce an unfunded balance sheet liability.[97]

Gault did not recall any discussion with Grasso regarding Grasso's SERP benefits in connection with the 1995 contract. He did not recall the reasoning or justification behind the payout of SERP benefits to Grasso, nor whether there was any discussion about whether any limit or cap should be placed on Grasso's contractual SERP-like benefits going forward, under the 1995 contract.

2. 1999 Contract

As early as March 1998, discussions began regarding a new employment agreement for Grasso.[98] At the time, Grasso's 1995 contract was set to expire on May 31, 2000. According to Grasso and various Committee members, Grasso did not request an extension of his 1995 contract; rather, the idea originated with the Committee, which then brought the recommendation to the Board. The Committee believed that Grasso was performing well and wanted to lock him in for a few more years as Chairman. At the same time, the Committee also wanted to lock in William R. Johnston, President and Chief Operating Officer of the NYSE at that time, and discussed a new contact for him as well.[99]

Bernard Marcus was Chairman of the Compensation Committee at that time and said that he was the "point person" regarding the contract negotiations. In February 1999, Marcus created a subcommittee consisting of himself and three others for the purpose of recommending new employment agreements for Grasso and Johnston."[100] Marcus was the only subcommittee member who had any recollection of the negotiations relating to Grasso's 1999 contract.

One of the key terms included as part of the 1999 contract was the transfer of about $29.9 million in accumulated SERP benefits from Grasso's SERP account to his SESP account. Grasso stated that he requested the SERP-to-SESP transfer. Grasso said he believed that his contract provided him with the option of taking a lump sum payment at the end of the contract terms, and that, if his old contract was being terminated and a new one starting, he could elect to either take out the pension benefits or transfer them into SESP. When asked why he elected to ask for a transfer of the SERP funds to his SESP account, rather than ask for a payout like he did in 1995, Grasso explained that he simply wanted to be able to control the investment of the funds through his SESP account and did not want a payout.

Marcus similarly recalled that the purpose of this transfer was to allow Grasso to take advantage of market rates and invest in mutual funds, and to give Grasso control of his own financial future. He said that the Compensation Committee unanimously agreed that it was the proper thing to do. Marcus recalled that the idea of the SERP-to-SESP transfer originated with the consultants who worked with the Committee.

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97 *See* NYSE 000054-58.

98 *See* NYSE 029779.

99 *See* NYSE 000062.

100 *See* NYSE 029663-64.

In fact, a March 30, 1998 letter from William Mischell of Mercer to Dale Bernstein reflects that, more than a year prior to the signing of Grasso's 1999 contract, Mercer suggested that, if Grasso's contract was renegotiated and Grasso wanted to take out his SERP benefits in connection with entering into a new contract, then, as an alternative to giving Grasso a lump-sum pension payment, the NYSE could consider allowing Grasso to transfer his SERP benefits to his SESP account.[101] Mischell pointed out that this would allow Grasso to continue to defer taxes, and give him some control over how the funds were invested. Mischell further advised that this approach would give Grasso "an opportunity to receive significantly more money at retirement" because of the NYSE's practice "to subtract from the ultimate SERP lump sum the amounts which were already paid without an interest adjustment." (Emphasis in original.)

On March 4, 1999, almost a year after Mischell first suggested that the SERP-to-SESP transfer could be an option, the Committee held a meeting during which it had before it a summary of the proposed changes to Grasso's employment agreement. The terms included a salary of $1.6 million, a target ICP award of at least $800,000, a target LTIP award of not less than $2.5 million, participation in the CAP providing a 50% match of the ICP and LTIP awards in a given year, as well as transfer of his accrued lump-sum SERP benefits to his SESP account.

The Committee approved the recommendations of the subcommittee with the exception that Grasso's salary would remain unchanged from $1.4 million. Marcus was delegated authority, pending approval of the Board of the presented terms, to negotiate and execute the final agreement.

According to Marcus, the only input from Grasso regarding the contract came when Ashen called Marcus to tell him that Grasso thought the contract's mortality rate calculation was giving him too much money in SERP benefits and that it should be adjusted. Marcus worked with Ashen to make this change, and didn't wait for Compensation Committee approval on this issue because the change benefited the NYSE financially. He also made other minor, non-material changes to the contract with Ashen that he did not consider important enough to call the full Committee to review. Marcus stated that Ashen and attorneys for the NYSE handled the actual drafting and amending of the contract.

On May 3, 1999, Grasso's 1999 employment agreement was executed. This agreement provided for Grasso to serve as Chairman and CEO for a term beginning June 1, 1999 and continuing to May 31, 2005. Under this agreement, Grasso received: a base salary of $1.4 million; a target ICP award of at least $1 million; CAP benefits in the amount of at least 50% of his ICP award; a target LTIP award of at least $2.5 million per cycle; and contractual SERP-like benefits. In addition, pursuant to this agreement, on June 1, 1999, $29,928,062 million in accumulated SERP benefits were transferred to Grasso's SESP account. As noted above, several directors who were Committee members at the time indicated that they had no knowledge that Grasso received a lump-sum transfer from his SERP account to his SESP account.

Grasso's 1999 contract was later amended in 2001, following the termination of the LTIP. The purpose of the amendment was to adjust Grasso's compensation structure in light of the elimination of the LTIP. Specifically, the Committee determined that the "shortfall" in the compensation of the executives who previously had received LTIP awards, including Grasso, would be "made up" by increasing the executives' ICP awards to cover for the lost LTIP awards. Because the Committee did not want Grasso's increased ICP awards to result in excess contributions to Grasso's SERP benefits accumulation, the Committee decided to limit the amount of Grasso's ICP award that counted towards Grasso's SERP

[101] *See* NYSE 029779.

calculation and SERP benefits accumulation. Based on the analysis of Mercer[102] and Hewitt[103] the Committee determined that, by making only 85% of Grasso's ICP award SERP-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.

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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.

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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.

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[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.[117] 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]

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116 *See* NYSE 052964-65.

117 *See* NYSE 049102-05.

118 *See* NYSE 049102-03.

119 *See* NYSE 049110-11.

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 SERP 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 SERP 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 SERP pension benefits and deferred compensation, Vedder, Price's analysis stated:[124]

- 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 back up 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]

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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.

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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 to 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, 2003[132] (though apparently prepared earlier than March 28), analyzed various provisions of the proposed contract and offered the following:

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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 SERP 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 SERP 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 firestorm" 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 firestorm." 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.

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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.

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[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 his [illegible]) 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	5,100,000
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 6/30/07 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

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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 wits 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 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.

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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 SERP 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.

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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

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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 SERP 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:

Date	Amount
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:

Vesting Dates	Amount
Grasso's 57th Birthday (7/26/03)	$1,449,822
Grasso's 58th Birthday (7/26/04)	$2,950,630
Grasso's 59th Birthday (7/26/05)	$3,115,866
Grasso's 60th Birthday (7/26/06)	$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 reviewed 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

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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 048041-43.

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.

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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.[165]

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 serving 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.

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165 *See* NYSE 006186-87.

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.

1999[167]

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, 042409-11.

2000[168]

Officer	Benchmark	Actual Comp.	%
Grasso	$11,087,607	$26,806,000	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

2001[169]

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

2002[170]

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 Contributions[176]

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.

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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 participating 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.[181] 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.

IV. ANALYSIS OF THE REASONABLENESS OF THE LEVELS OF GRASSO'S COMPENSATION AND BENEFITS

A. Overview of Expert Review and Analysis

In assessing the reasonableness of Grasso's compensation and pension benefits, we retained three preeminent experts in the field of executive compensation: Alan M. Johnson of Johnson Associates, Inc. ("Johnson"); Frederic W. Cook of Frederic W. Cook & Co., Inc. ("Cook"); and Brian T. Foley of Brian Foley & Co., Inc. ("Foley"). Each has provided an expert report or opinion letter on issues concerning Grasso's compensation.

Johnson performed an in-depth analysis of the records and information we gathered during the Investigation.[189] He thoroughly analyzed the process that the NYSE Compensation Committee employed to reach its compensation decisions and examined the reasonableness of the levels of compensation and benefits awarded to Grasso. Johnson prepared it detailed written report outlining his findings, with supporting data and charts explaining his analysis (the "Johnson Report").

Consistent with the generally accepted practice in evaluating and analyzing executive compensation, Johnson created an appropriate comparator group, or peer group, against which to benchmark the compensation and benefits awarded to Grasso (the "Johnson Comparator Group").[190] Also pursuant to the standard and accepted methodology in executive compensation analysis, the Johnson Comparator Group reasonably reflects the complexity and size of the NYSE, in terms of various factors including revenue, income and assets.[191] As discussed *infra*, Johnson determined that the comparator group employed by the NYSE Compensation Committee to benchmark Grasso's compensation was entirely inappropriate, for a number of reasons.

The Johnson Comparator Group does not include all of the other exchanges that might be used in a comparator group for the NYSE, but instead includes companies that, on average, have higher net income and employees than the NYSE, but have roughly equivalent revenues.[192] Thus, the comparator group has a moderate upward bias in Grasso's favor, resulting in higher benchmarks for Grasso's compensation and benefits than other potential reasonable and appropriate comparator groups would have produced.[193]

In assessing the reasonableness of Grasso's compensation and benefits, Johnson evaluated Grasso's actual compensation and benefit awards and compared them to the compensation and benefits awards of the Chairmen and CEOs of the companies in the Johnson Comparator Group. Johnson also considered other facts and circumstances, including information about the comparator group used by the NYSE Compensation Committee, the compensation levels of others at the NYSE, general market information, and his knowledge and experience.

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189 *See* Johnson Report at 1.

190 *Id.* at 2-3, Johnson Report Exhibit 2.

191 *Id.*

192 *Id.*

193 *Id.*

Cook and Foley reviewed and approved of Johnson's analysis and provided expert advice on a number of executive compensation issues pertinent to the analysis of the reasonableness of Grasso's compensation and the process by which compensation and benefits decisions regarding Grasso were made. Cook and Foley agree that the Johnson Comparator Group is a reasonable and appropriate comparator group against which to benchmark Grasso's compensation, and that the comparator group used by the NYSE Compensation Committee was not an appropriate comparator group for Grasso. They each prepared opinion letters (the "Cook Opinion Letter" and the "Foley Opinion Letter") concurring in and supporting Johnson's analysis and conclusions, and providing additional analysis on various key aspects of Grasso's compensation and benefits and the compensation process for Grasso.

Importantly, in performing their analyses, each of the experts assumed that, during Grasso's tenure as Chairman and CEO, he performed at an outstanding level. This was an assumption that the experts were provided rather than a finding that they made independently.

During the course of our Investigation, we gathered information concerning Grasso's performance level during the time he was Chairman and CEO. In general, most Board members we interviewed believed that Grasso performed very well as Chairman and CEO throughout his tenure. Others felt that he performed well as a CEO, but not nearly as well as Chairman. However, determining the level of Grasso's performance in all areas of his duties and responsibilities over the years would be a very time-consuming and fact-intensive inquiry. Due to time constraints and other legal and practical limitations, we did not conduct such a full and complete inquiry and, therefore, we have not developed a sufficiently complete factual basis to determine the level of Grasso's performance as a Chairman and CEO.[194] Nevertheless, for purposes of our analysis of the reasonableness of the levels of his compensation and benefits, we have assumed that his performance was outstanding.[195]

B. Analysis of Grasso's Benefits

According to Johnson, Cook, and Foley, by any reasonable standard, the level of Grasso's pension accumulation and payouts was excessive. Applying appropriate executive compensation analysis, including assessing and benchmarking Grasso's accumulated pension benefits against an appropriate comparator group, it is clear that Grasso's pension benefits were well above what was reasonable.

To assess the reasonableness of Grasso's pension benefits, we first determined his total pension benefit accumulation at the time his new employment agreement was approved by the Board on August 7, 2003. Specifically, we examined what Grasso would have received in pension benefits if he had resigned on that date.

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[194] For example, we did not interview all of the approximately fifty-nine Board members who were on the Board at some point during Grasso's 8-year tenure as Chairman and CEO, but instead interviewed only those with the strongest connections to Grasso's compensation issues – former members of the Compensation Committee and members of the Board at the time Grasso's 2003 employment contract was approved by the Board. We also interviewed staff and certain NYSE consultants, but we did not interview other third parties outside the NYSE or a broader range of Board members and others connected to the NYSE who would have a wide range of information and perspectives about Grasso's performance.

[195] Of course, this assumption does not cover issues relating to his own compensation that were the subject of the Investigation.

According to Johnson, by August 7, 2003, Grasso had accumulated pension benefits pursuant to which he was entitled to receive a lifetime annuity of about $7.4 million.[196] Applying the lump sum SERP calculation provided under Grasso's 1999 contract, his lump sum pension benefit, if he had received the entire benefit on August 7, 2003, would have been about $119.4 million.[197] Because Grasso already had received pension payouts prior to August 7, however, the present value of his pension on August 7, 2003 was even larger. Specifically, accounting for interest on the approximately $6.5 million pension payout that Grasso received in June 1995 and the approximately $29.9 million he received in a SERP to SESP transfer in June 1999, his lump-sum present value pension benefit on August 7, 2003 was about $126.4 million.[198]

Grasso not only accumulated a large pension, he actually received large pension payouts or transfers on three separate occasions: (1) a payout of about $6.5 million in June 1995; (2) a transfer into his SESP of about $29.9 million in June 1999; and (3) a payout of about $51.6 million in September 2003. These amounts total about $88.0 million in actual pension payments. When interest is factored in on the two earlier payments, the value of Grasso's actual pension payouts is about $95.1 million.[199]

In addition, under his 2003 contract, Grasso negotiated the right to receive future SERP payments, including $28.6 million in scheduled payments from 2004 to 2007. Depending on various circumstances, Grasso also could have received even more SERP benefits in the future beyond those scheduled payments.[200]

When Grasso's pension benefits are compared with the compensation and benefits of Chairmen and CEOs in the Johnson Comparator Group, it is clear that Grasso's benefits were unreasonably excessive. As a general principle, top executives of the companies in an appropriate comparator group receive pension benefits at roughly the 75th percentile of the range of pension benefits levels in the comparator group.[201] For the Johnson Comparator Group, the 75th percentile pension benefit level is in the range of about $875,000 per year, and the highest pension among those executives would be about $1.5 million per year.[202] The total pension benefits of those executives, measured in lump sum, present value terms, would have been in the range of $12.8 million.[203] The lump-sum present value of the top pension in that group would be about $21.7 million.[204]

Thus, using the Johnson Comparator Group analysis, Grasso's actual accumulated pension benefits were eight to ten times what they should have been, and five to six times the highest pension among his peers.[205] In lump-sum terms, under Johnson's analysis, Grasso's accumulated pension benefits of about

196 *See* Johnson Report at 4, Johnson Report Exhibit 3.

197 *Id.*

198 *Id.*

199 *Id.*

200 *Id.* at 4.

201 *Id.* at 5.

202 *Id.*

203 *Id.*

204 *Id.*

205 *Id.*

$126.4 million were excessive by about $113.6 million, and Grasso's receipt of pension benefits totaling about $95.1 million (with interest on prior payments included) caused Grasso to receive about $82.3 million in excess pension payments.[206]

Cook and Foley are in agreement that Grasso's pension benefits were excessive. Cook and Foley both concur that the Johnson Comparator Group is an appropriate comparator group against which to benchmark Grasso's compensation, and that such a benchmarking analysis shows that Grasso's pension was at unreasonable levels. Cook agrees that, applying the Johnson Comparator Group analysis, the amount of excess pension benefits is approximately $113.6 million.

While Foley agrees that Johnson's analysis is reasonable and appropriate, and concurs in the conclusion that Grasso's pension benefits were unreasonably excessive, Foley also offers an alternative analysis for calculating the excess pension amount. Specifically, applying a rough industry formula for applicable pension benefits (60% of annual pensionable compensation) and a reasonable level of annual pensionable compensation ($3 million to $3.5 million) for Grasso, Foley estimated that a reasonably generous pension annuity for Grasso would be in the range of about $1.8 to $2.1 million, and a reasonably generous lump-sum pension benefit level for Grasso would be about $20 million to $25 million. Under this analysis, Grasso's total pension accumulation of approximately $126.4 million would be excessive by about $101.4 million, and Grasso's actual pension payout totaling over $95.1 million would have resulted in Grasso actually receiving about $70.1 million in excess pension benefits.

Moreover, Grasso's pension benefits are excessive even when judged against the pensions of CEOs in the group of top financial services firms used by the NYSE as a comparator group for determining Grasso's compensation. As discussed, *infra*, the NYSE Compensation Committee never performed a benchmarking analysis of Grasso's pension benefits. If the Committee had done so, it would have learned that, even when judged against the Committee's comparator group, Grasso's pension benefits levels were excessive and unreasonable.

The pensions of top Chairmen and CEOs at the 75th percentile of companies in the NYSE's comparator group would be about $2.1 million, and the highest pension among those executives would be about $3.6 million per year.[207] The lump-sum present value of those pension benefits would be in the range of about $30.7 million, and the highest lump-sum pension benefits in that group would be about $52.7 million.[208] Thus, Grasso's pension benefits were three-and-a-half to five times the pension benefits of a top-performing Chairman and CEO of a company in the NYSE's comparator group, and more than twice the highest pension in that group. Accordingly, even analyzing Grasso's pension benefits against that comparator group, Grasso's accumulated pension was excessive by at least $73.7 million, and as much as $95.7 million, and his pension payouts were excessive by at least $42.4 million and as much as $64.4 million.

As Johnson further points out in his Report, the lump sum pension payments Grasso received in 1995 and 1999 by themselves would have funded a generous or very generous pension benefit in comparison to the appropriate market.[209] The additional $51.6 million lump-sum payment Grasso received pursuant to his

206 *Id.*

207 *See* Johnson Report at 5, Johnson Report Exhibits 4, 6.

208 *Id.* at 6, Johnson Report Exhibit 4.

209 *Id.* at 6.

2003 employment contract was itself – putting aside the prior payments of $6.5 million and $29.9 million, and the interest accrued on those sums – equal to the highest pension in the comparator group used by the NYSE and two and a half times the highest pension in the Johnson Comparator Group.

Finally, the decision to allow Grasso to repeatedly "cash out" his pension benefits while he was still employed at the NYSE was, at the very least, highly unusual.[210] Grasso's receipt of repeated payouts of his pension effectively turned his pension into a cash compensation device, which was against standard executive compensation practice.

C. Analysis of Grasso's Annual Compensation

All three of our experts also agree that Grasso's annual compensation was unreasonable and excessive, and that he was overcompensated by about $43.1 million.

As detailed *infra*, between 1995-2002, Grasso was paid $97.8 million in salary, annual incentive compensation, long term incentive compensation and special bonuses.[211] Judged against the Johnston Comparator Group. Grasso's overall compensation during his tenure as Chairman and CEO was well above a reasonable level. Based on the Johnson Comparator Group, Grasso should have received compensation over the period 1995-2002 of no more than $54.7 million.[212] Thus, Grasso's $97.8 million in compensation during that span resulted in him receiving at least $43.1 million in excessive compensation.[213]

Viewed from year to year, instead of in the aggregate over his tenure as Chairman and CEO, it is clear that Grasso's overcompensation was concentrated in the later years of his tenure, during the period 1999-2002. A Chart depicting Grasso's actual compensation, the benchmarks used by the Committee each year, and Johnson's year-by-year overcompensation analysis is attached as Exhibit 4.

Grasso's level of compensation during the years 1995-1998 arguably was within the range of reasonableness. During that timeframe, a conservative approach to Grasso's appropriate compensation level, based on the median level (50th percentile) of the Johnson Comparator Group, would have been to award Grasso compensation in the range of $2 million to $3 million, or perhaps slightly above the median.[214] Alternatively, placing Grasso at the 75th percentile of an appropriate peer group for outstanding performance, his appropriate compensation level would have reached roughly $3 million to $6 million.[215] During this period, Grasso's actual compensation was $2.1 million (1995) to $6.0 million (1998). Thus, his actual compensation arguably was within a reasonable range through 1998.[216]

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210 *Id.*

211 *See* chart, Grasso's Total Compensation By Year, *Supra* at 16.

212 *See* Johnson Report at 6 and Johnson Report Exhibit 7.

213 *Id.*; *see also* Cook Opinion Letter at 1-2; Foley Opinion Letter at 4.

214 *See* Johnson Report, Johnson Report Exhibit 7.

215 *Id.*

216 Notably, several Compensation Committee members who served during the period 1995-1998, when shown Grasso's compensation awards for 2000 ($26.8 million) and 2001 ($30.55 million), expressed the view that the compensation awards in those years were at unreasonable levels, commenting that the numbers were "crazy" or "just nuts" or "getting out of hand."

During the period 1999-2002, however, Grasso's compensation was clearly excessive. A conservative estimate of what Grasso's yearly compensation should have been is $4 million to $6 million, based on the median level (50th percentile) of the Johnson Comparator Group.[217] Alternatively, if Grasso were paid commensurate with the 75th percentile of the appropriate peer group based on outstanding performance, he would have been paid a total of about $8 million to $9 million per year. Thus, over the four year period from 1999-2002, Grasso should have been paid roughly $20 million by a conservative estimate of where he should rank among the appropriate peer group (50th percentile), or approximately $34 million by a more generous estimate of where he belonged in the appropriate peer group (75th percentile).[218]

Instead, Grasso was awarded compensation of $11.3 million for 1999, $26.8 million in 2000, $30.56 million in 2001, and $12 million in 2002 – for a total of approximately $80.7 million in actual compensation over the four year period. Thus, he received substantial excess compensation over that span. For the years 2000 and 2001, Grasso's compensation was grossly excessive, approximately three to four times what was reasonable.

Grasso's compensation also is unreasonable when viewed against those of the other senior executives. While standard practice is for the next most senior executive's compensation to be at least 50% to 70% of the CEO's, Grasso made many times what Johnston, Britz and Kinney made, especially in the period 1999 through 2001.

In 1999, Grasso's compensation ($12.1 million) was about 10 times what Britz and Kinney received ($1.7 million), and roughly three times what Johnston received $4.4 million). In 2000, Grasso's compensation ($26.8 million) was about twelve times what Britz and Kinney received ($2.3 million) and was more than five times what Johnston received ($5.1 million). Finally, in 2001, Grasso's compensation ($30.6 million) was more than seven times what Britz and Kinney received ($4.2 million) and was about six times what Johnston received ($5.8 million).

This large disparity between Grasso's compensation and that of his fellow senior executives exceeded any normal or reasonable relationship and, in the opinion of our expert, Johnson, was a clear red flag reflecting significant problems in senior executive compensation at the NYSE.

Finally, Grasso's compensation also is excessive when viewed historically, over the course of his tenure as Chairman and CEO. He initially was paid about $2 million in total annual compensation in 1995. By 1998, his annual compensation had tripled to about $6 million. In 1999, his compensation nearly doubled in one year, going from $6 million in 1998 to almost $12 million in 1999. Then in 2000, it doubled again, going from about $12 million to over $26 million. Grasso's total compensation for 2001 – about 30.6 million – was about ten times the $3 million he received in 1996, his first full year as Chairman and CEO, despite the fact that his job responsibilities had not materially changed. These large jumps in Grasso's compensation on a year-to-year basis, when his job responsibilities had not changed substantially, also suggest that his overall compensation level was unreasonable, particularly in the latter years of his tenure.

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217 *See* Johnson Report at 6-7, Johnson Report Exhibits 7-9.

218 *See* Exhibit 4.

D. Grasso's Compensation and Benefits Considered Jointly

Independently, Grasso's compensation and pension benefits clearly were excessive in substantial amounts. Considered together, the magnitude of Grasso's excessive compensation and pension benefits was grossly unreasonable. Grasso was awarded at least $43.1 million in excess compensation, and his pension accumulation was excessive by approximately $101.4 million to $113.6 million. Thus, the level of his compensation and pension accumulation, considered together, was excessive by approximately $144.5 million to $156.7 million.

As noted above, based on his excessive pension accumulation, Grasso received pension payments in the amount of approximately $88.1 million which, when factoring in interest earned on prior payments, had a present value of $95.1 million in August 2003. Because his pension should have been in the range of $12.8 million to $25 million, the value of the pension payments he received was excessive by about $70.1 million to $82.3 million. Thus, the total amount of excessive compensation and benefits that Grasso actually received was in the range of about $113.6 million to $125.4 million.

E. Overcompensation of Others

While not initially part of our inquiry, during the course of the Investigation we became aware of at least two instances in which Grasso was involved in other NYSE employees receiving questionable levels of compensation. First, former NYSE President William Johnston received a special payment of $6 million dollars from the NYSE in 2001, after he announced he was stepping down as NYSE President. There appears to be no legitimate basis for this payment, which was generated as a result of Grasso's efforts.

Grasso and Johnston agree that the payment was not for retentive reasons, but was provided to Johnston for his past years of service at the NYSE and also in recognition that Johnston would have made a lot more money had he stayed in the private sector rather than joining the NYSE in 1996. The size and reasons for this payment raise serious questions about its reasonableness.

We also have learned that Grasso's executive assistant was paid approximately $240,000 per year for the last three years, and that Grasso used two drivers on the NYSE payroll who each earned approximately $130,000 per year. Johnson Associates has determined that the appropriate level of compensation for these NYSE staff members, even if they had a high level of seniority and were excellent performers, was in the range of $80,000 to $85,000 for Grasso's executive assistant, and approximately $65,000 for each of the drivers.[219] Thus, the amounts actually paid to these staff members, amounts that are two to three times the appropriate levels, appear excessive and unreasonable.

[219] *See* Johnson Report at 11, Johnson Report Exhibit 11.

V. ANALYSIS OF THE FACTORS CONTRIBUTING TO GRASSO'S UNREASONABLE LEVELS OF COMPENSATION AND BENEFITS

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.

A. Failure to Adequately Design, Monitor, and Oversee Grasso's SERP Benefits

Grasso's SERP benefits grew to unreasonably high levels for a number of reasons. First and foremost, the SERP benefits levels were driven by the unreasonable and excessive compensation awards that Grasso received, particularly for the years 2000 and 2001. Because Grasso's SERP benefits calculation was tied in large part to his "final average pay" – calculated as his three consecutive highest years of salary and bonus in the last 10 years before retirement – his SERP benefits increased dramatically as he was awarded large bonuses. In fact, approximately $82.9 million of his SERP benefits had accumulated since his last SERP benefits payout in 1999. If Grasso had not received such high bonuses during the period from 1999 2002, his level of SERP benefits would not have climbed so high.

Second, Grasso's SERP benefits were not subject to any reasonable limits or caps. Many companies design their SERPs to include caps on the amount of SERP benefits that an executive can receive, or limit the amount of the executive's bonus or other compensation that can contribute to the executive's SERP calculation.[220] Grasso's employment contracts, pursuant to which he received his contractual SERP-like benefits, placed no limitations on the growth of Grasso's SERP benefits or the amount of Grasso's bonus that would be included in the calculation of Grasso's SERP benefits.

In Grasso's case, caps or limitations on his SERP benefits were a particularly important considerations as they would have limited the growth of his SERP benefits, given his many years of service at the NYSE. Because the other main component of Grasso's SERP benefits calculation (besides final average pay) was his total years of service, his many years of employment at the NYSE should have been taken into account when structuring his contractual SERP-like benefits to ensure that they had reasonable limitations.

Third, 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 amounts of bonuses to Grasso without fully analyzing the impact of those bonuses on Grasso's accumulation of SERP benefits. Because the Committee did not adequately monitor the SERP benefits levels, Grasso's SERP benefits were able to reach excessive levels essentially unchecked.

Fourth, 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. As set forth *infra*, had the Committee done so, it would have quickly seen that, even when judged against the Committee's comparator group, the pension level was well beyond what was reasonable in the marketplace.

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220 *See* Johnson Report at 10.

Fifth, when the Committee did become aware that Grasso's SERP benefits accumulation was reaching high levels, it did not take sufficient preventive or corrective action to get the SERP benefits accumulation under control. According to some on the Committee, in 2001 and 2002, when concerns were raised in Committee meetings about the level of SERP accumulation, the Committee "carved out" $5 million from Grasso's ICP award to try to keep Grasso's SERP benefits levels from growing too high. However, the Committee performed no analysis to determine whether the $5 million "carve-out" was a sufficient step to try to control the SERP accumulation. The $5 million carve-out amount was not based on any reasonable assessment or analysis of any kind and, ultimately, was woefully inadequate to bringing the SERP within a reasonable level.

Likewise, in connection with the renegotiation of Grasso's 1995 and 1999 contracts, when the Committee learned that Grasso had accumulated substantial amounts of pension benefits, it took no steps to try to correct his runaway pension accumulation. In 1999, when Grasso's 1995 contract was renegotiated, his SERP benefits accumulation at that time was already over $36 million, more than three times what a reasonable pension would have been, according to the Johnson Comparator Group analysis that has been accepted by Johnson and Cook. The Committee took no steps to control the accumulation of SERP benefits, but instead approved a SERP-to-SESP transfer of $29.9 million.

In the fall of 2002, when the Committee began exploring renegotiating Grasso's 1999 contract, the Committee again learned of Grasso's high SERP benefits accumulation and again took no corrective action or measures. Instead, it again approved a large payout of the SERP benefits, despite learning at that time that Grasso's SERP benefits level was about five times what a reasonable pension benefits level would be.

Thus, rather than monitor and control Grasso's SERP benefits, the Committee allowed the SERP benefits to be used like a cash compensation device through which it funneled millions of dollars in excessive pension amounts to Grasso.

To rectify and prevent in the future such SERP-related problems, the NYSE should consider implementing caps or limits on SERP accumulation. As noted, such caps are common in the executive compensation industry. The NYSE also could consider eliminating or revising the lump-sum option for SERP benefits. This would avoid the opportunity and incentive for lump-sum payouts while the executive is still employed. Finally, the Compensation Committee, as part of its yearly analysis of compensation for senior management, should review and consider the benefits to which such executives are entitled and monitor their accumulation of SERP benefits.

B. Faulty Mechanics/Process Used to Determine Grasso's Annual Compensation

The process by which Grasso's annual compensation was determined was flawed in several respects. The Compensation Committee: (1) used an inappropriate comparator group for benchmarking Grasso's compensation levels; (2) obtained only incomplete data about its comparator group and used the comparator group data in unconventional and fault), ways to create unreliable and inflated benchmarks for Grasso's compensation; and (3) arbitrarily departed upwards from its own inflated benchmarks, in some years awarding Grasso more than twice the benchmark.

1. Inappropriate Comparator Group

All of our experts agree that the comparator group used by the Compensation Committee was not an appropriate comparator group against which to benchmark Grasso's compensation.[221]

Experts in the area of executive compensation typically employ specific criteria to determine appropriate comparator groups and, under an appropriate analysis, a comparator group should be comprised of companies that reasonably reflect, in important characteristics, the company of the executive whose compensation is being evaluated. These characteristics include revenue, net income, number of employees, assets, or other standard measures of size or complexity.[222]

The NYSE is dramatically different from the comparator group employed by the Compensation Committee in these characteristics. As set forth in the comparator group analysis performed by Johnson, the NYSE is substantially smaller than the comparator group companies used by the Committee in terms of revenue, net income, number of employees, and other critical measures.[223] The Compensation Committee should not have ignored these glaring differences in selecting a peer group for Grasso.

Notably, in recognition that the NYSE is not quite at the level of complexity of the comparator group companies, beginning in 1999 the Committee began to discount the median comparator group compensation level by 10% before using that level to further benchmark Grasso's compensation (and discounted the median compensation level of the comparator group's presidents by 30% before using that number as a benchmark for the compensation level of the NYSE's Presidents). This adjustment was applied to account for the variance in size and complexity of between the NYSE and the comparator group companies. However, this was an admittedly arbitrary discount that bore little relation to any reasonable comparison between the comparator group companies and the NYSE. In the view of our experts, this adjustment was wholly inadequate to account for the large disparity between the comparator group companies and the NYSE.

2. Incomplete Data and Faulty Benchmarking

The Compensation Committee not only used the wrong comparator group, it also used incomplete data from that group and then manipulated that data in a manner that created inflated and inappropriate benchmarks for Grasso's compensation.

Our experts agree that, when conducting a comparator group analysis, a compensation committee at a minimum should be given a series of data points along a range of compensation levels for the CEOs of the comparator group companies.[224] Ideally, this data should include the entire percentile range of the comparator group so that the executive can be judged against not only the median, but also the 25th percentile, the 75th percentile, and other points in the range.[225]

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221 Johnson Report at 7; Cook Opinion Letter at 2; Foley Opinion Letter at 2.

222 *See* Johnson Report at 2-3, 7-8.

223 *Id.*

224 *See* Johnson Report at 7-8. *See also* Cook Opinion Letter at 2; Foley Opinion Letter at 4-5.

225 *Id.*

A full range of data points for the comparator group allows for an assessment of the executive's competitive position in the marketplace. Knowing the actual competitive positioning is critical to determining whether that particular level of compensation is reasonable and appropriate.[226]

The Compensation Committee never obtained a full range of data points to perform a proper assessment of Grasso's competitive positioning in any year. While at times Ashen and his staff received such information, it was never provided to the Committee and was not used by Ashen to create the executive compensation worksheets or perform the benchmarking for the Committee. Instead, Ashen used only the median or target median level for benchmarking. As a result, the Committee had insufficient means to determine what Grasso's final competitive positioning was and insufficient means to assess the reasonableness of his compensation.

Furthermore, the Committee's benchmarking formula – pursuant to which it multiplied the performance factor of the NYSE (as determined by the ICP performance evaluation) by the median or target median of the comparator group – was an inappropriate and misleading method by which to benchmark Grasso's compensation for a number of reasons.

First, as the Committee well knew, Grasso had a strong hand in determining the performance of the NYSE through a variety of factors, including selecting the empirical criteria, setting the weights and targets for the empirical criteria, and in his sole discretion determining the Chairman's Award. Thus, by directly multiplying the median of the comparator group by a number that Grasso was largely responsible for creating, the Committee effectively allowed Grasso to have a strong hand in determining his own benchmark and thereby influence his own compensation. This is particularly true in light of the fact that the Chairman's Award greatly exceeded the performance level on the empirical criteria in many years.

Second, the fact that the NYSE performed consistently above the targets set each year suggests that targets may have been set low and should have been more carefully examined.[227] On average, during Grasso's tenure the NYSE achieved 135% of its performance targets, and six of the eight years was at 130% or higher. It is rare for any company to consistently outperform its targets, if set fairly and reasonably, to such an extent over an eight-year period. The Committee, therefore, should not have so rotely applied the performance factor of the NYSE in the benchmarking formula, but should have considered that performance with other factors in selecting an appropriate compensation range.

Third, even setting aside Grasso's input into the benchmarking process when this formula is applied and the questions about the performance factor, the Committee's formula itself is misleading because it is based on incomplete data and has no reasoned basis. By applying this formula, the Committee had no idea where Grasso was situated each year within the range of the comparator group. The only thing the formula determined is that Grasso's compensation was equal to some multiple of the target or actual median. That multiple could have placed Grasso at the 95th percentile or the 65th percentile; without more data points, the Committee had no way of knowing each year where exactly Grasso's compensation level placed him in the comparator group. Basing its compensation decisions on such incomplete and potentially misleading data was an unreasonable approach to compensation decisions.[228]

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226 *Id.*

227 *Id.*

228 Johnson Report at 7-8. . . .

3. Capricious Upward Adjustments From Already Inflated Benchmarks

Perhaps the most important part of the compensation process is the final determination of the compensation level. After analyzing the comparator group data and determining the CEO's performance, a compensation committee should then make a reasonable assessment of what to pay the CEO.[229] The NYSE Compensation Committee did not make sound or defensible judgments with respect to its decisions for Grasso.

In advance of its final compensation decision for Grasso, the Committee already had created overly generous benchmarks for Grasso by inappropriately comparing him to the top executives at large profit-making institutions, and then multiplying the median level of that group's compensation times the NYSE performance factor that Grasso had had a hand in determining. The Committee then compounded its errors by increasing Grasso's annual bonus with little effort to tie the increase to the market data or any other specific criteria.[230] For example, in 2000 the Committee adjusted Grasso's compensation from a stated benchmark of about $11.1 million to $26.8 million. Again in 2001, the Committee increased his compensation from a stated benchmark of about $18.6 million to $30.6 million. Our experts have determined that there is no reasonable or supportable basis for these adjustments.

Indeed, the main reason offered by the Committee members for their large upward jumps from the already generous benchmarks was that Grasso had performed at an outstanding level, but the Committee had already taken that into account in its benchmarking. Importantly, Grasso and many other directors acknowledged that the ICP performance evaluation was an accurate measure of the performance of Grasso and the NYSE and fully captured all of the various aspects of the NYSE's performance. The Committee already had used that information in 2000 and 2001, for example, to multiply the median of its comparator group by 155%. Awarding Grasso multiples of the benchmark that already had been adjusted significantly for Grasso's performance was arbitrary, capricious and unreasonable.

To address these problems outlined above, 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.

C. 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.[231] The NYSE's 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 SERP benefits, or the NYSE's SERP program, 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. Hewitt did

229 Johnson Report at 9.

230 *Id.*

231 Johnson Report at 10; Cook Opinion Letter at 2.

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.

VI. ANALYSIS OF THE EVENTS CONCERNING THE APPROVAL OF GRASSO'S 2003 CONTRACT

The facts and circumstances surrounding the Board's approval of Grasso's 2003 employment contract show that the approval was based at least in part on incomplete or inaccurate information and, in some respects, without adequate deliberation.

A. Inadequate Process/Deliberation for the Decision

As a preliminary matter, it is clear that the Board's deliberation on the proposed contract extension and payout of deferred compensation and benefits for Grasso was rushed and proceeded without the kind of advance notice, documentation, or process that should have accompanied a decision of the magnitude the Board faced. Grasso's contract extension and payout was not on the agenda for the August 7, 2003 Board meeting and, in fact, Board members had been led to believe that the issue was not going to be raised that day. No materials were sent out in advance of the meeting for the Board's consideration on this issue, and very minimal documentation was provided to the Board about Grasso's contract extension at the meeting. The consultants who knew and understood the proposal were not at the meeting, nor was Ashen.

Many Board members at the meeting were confused about the issues and were not presented with sufficient information to understand the issues or the contextual framework for considering the issues. The discussion at the meeting was incomplete and at times inaccurate or misleading, leading to further confusion and misinformation.

B. Failure to Disclose the $48 Million in Scheduled Future Payments to the Full Board

The full Board clearly was not informed of a critical fact: the $48 million in scheduled future payments of deferred compensation and benefits provided for under Grasso's 2003 employment agreement.[232] This material fact should have been disclosed to, and considered by, the full Board in its decision-making regarding the 2003 contract.

Board members who were not on the Compensation Committee were not provided with any document that referenced or discussed the $48 million, or otherwise would have given them reason to believe that any future payments of benefits or deferred compensation would be due under the 2003 contract. The only document the Board received at the August 7 meeting about the contract proposal – the handout Ashen prepared for the Board – said nothing about the $48 million or any future payments. In addition, while the Speaking Points Ashen prepared for McCall specifically mentioned the approximately $28 million in scheduled payments of SERP benefits and the additional future CAP payments that were called for under the contract (though without listing how much the CAP payments were), the Speaking Points were not distributed to the Board.

There was no mention of the $48 million or any future payments during the protracted discussion at the August 7 Board meeting. McCall, the Chairman of the Committee responsible for advising the Board of the terms of the contract proposal at the August 7 meeting, did not raise the issue of the $48 million when

232 All directors we interviewed agreed that the $48 million was not discussed, except for one, who was not sure whether it was discussed.

he first addressed the Board or at any other point in the meeting. Despite having the Speaking Points Ashen had prepared for him, McCall never reviewed them and never imparted to the Board the information the Speaking Points contained.

Likewise, the other Committee members at the Board meeting, who had been provided with information about the $48 million during Committee meetings, did not mention the $48 million, even though the $48 million clearly was addressed at the Committee level. At the July 2003 Committee meeting during which the Committee voted to recommend to the Board that Grasso's contract be extended and that he receive a payout of deferred compensation and benefits totaling $139.5 million, the Committee had before it the July 2003 Mercer report outlining the proposed terms of the contract extension and payout, including the future payments.

The July 2003 Mercer report specifically set forth that, under the proposed new contract, Grasso would be entitled to substantial future payments of pension benefits and deferred compensation, including: (1) four payments of Grasso's SERP benefits in the amount of $7.138 million each in the years 2004-07 ($28.55 million); and (2) the portions of Grasso's CAP award that become vested each year during the life of the new contract, through 2007.

Moreover, several members of the Committee whose Committee service pre-dated June 2003 also had received other materials outlining the scheduled future payments to Grasso on several prior occasions, including in October 2002 and March 2003. These former Committee members had participated in private meetings with Ashen and William Mischell of Mercer in March 2003 to discuss the proposed terms of the contract. Thus, the issue of the future payments was raised at the Committee level and Committee members should have been aware of the future payments called for under the contract.

Despite having received these materials regarding the $48 million, some on the Committee have stated that, at the time of the August 7, 2003 Board meeting, they were unaware that there were any future payments called for in the contract proposal. Other Committee members have acknowledged that, through the Committee's discussion and documents the Committee was provided regarding the proposed contract, they knew about the $48 million in scheduled payments.

However, no one of the members on the Committee who knew about the $48 million raised the $48 million at the August 7 Board meeting, despite acknowledging that McCall was struggling to explain the proposal adequately and that McCall was not discussing the $48 million. These Committee members continued to press ahead for approval of the contract without providing their fellow Board members with the information they needed to fully understand the proposal that was before them. One of these Committee members suggested to McCall that he bring Ashen into the meeting to explain the proposal, but when McCall refused that suggestion, the Committee member did nothing himself to himself attempt to clarify the confusion in the meeting.

Significantly, not only was the Board not told that the contract called for the $48 million in future payments of deferred compensation and pension benefits to Grasso, the Board actually was told the opposite – that payment of the $139.5 million to Grasso would result in his termination from participation in the programs that had allowed his pension to become so large. Indeed, the only references to future payments to Grasso at the August 7 meeting were statements by McCall and others to the effect that there would be *no* further payments of deferred compensation or benefits to Grasso. That statement was not corrected by those Committee members who knew about the $48 million.

Such statements were entirely misleading and inaccurate, for at least two reasons. First, the bulk of the $48 million was (i) a contractual payout of SERP benefits based on a SERP calculation that assumed Grasso would continue to work at the NYSE through the end of the 2003 contract (June 2007); and (ii) a payout of CAP awards. Second, the Board was not advised that, depending on the facts and circumstances of Grasso's leaving the NYSE, he possibly could have been entitled to further SERP-related benefits under the contract. Thus, the Board was not provided accurate information about the possibility of future payments to Grasso under the contract relating to deferred compensation and benefits.

C. Misinformation About the $139.5 Million Payout

At the Board meeting on August 7, the Board was told, inaccurately, that Grasso was fully entitled to the entirety of the $139.5 million payout. McCall and other current or former members of the Committee told the Board that the $139.5 million was "all his money" and that if he resigned from the NYSE that day, it would all be due to him. This was not true. Under the terms of Grasso's 1999 contract, Grasso's entire CAP account was forfeitable if Grasso left the NYSE prior to the end of the contract's term in June 2005. Thus, the CAP portion of the $139.5 million payout, which amounted to about $13 million, was not vested and owing to Grasso.

At the Committee level, Committee members had been told that the CAP portion of the $139.5 million was vested. Specifically, Ashen had characterized it as "vested" in materials he prepared for and distributed to the Committee and had told Mischell to characterize it as "vested" in Mercer's March 2003 report, and it remained characterized that way in Mercer's July 2003 report. Mischell specifically pointed out to Ashen that it was not technically accurate to refer to the CAP portion as vested, and cautioned that doing so might be misleading. Ashen, however, assured Mischell that he would clarify the issue for Committee members during the meetings he and Mischell were to have with them, and Ashen told us that he in fact did so. However, many Committee members said they believed that the entire $139.5 million, including the CAP portion, was due to Grasso and voted to recommend the proposed contract to the Board, in large part, on the basis of that belief. Committee members then conveyed their belief in this regard to members of the Board on August 7 in the face of questions as to whether the money was all Grasso's, whether he was legally entitled to it and whether it was all vested. Thus, ultimately, the Board was misinformed by the oral statements of various Committee members.

The three-page handout Ashen prepared and distributed to the Board at the August 7 meeting did make reference to the fact that Grasso's CAP awards were forfeitable under his current contract, though the discussion of CAP in the handout was somewhat ambiguous. In any event, Board members said they generally did not focus only on this handout but rather relied instead on what they were being told by Committee members; specifically, that Grasso was owed the entirety of the $139.5 million.

D. Misleading Information About Approval By Consultants and Lawyers

The Board was also given the misimpression that the NYSE's lawyers and consultants had approved the proposed contract. The Board was told by various Committee members at the August 7 meeting that the proposed contract had been reviewed and blessed by consultants and lawyers. This statement was misleading.

As an initial matter, there is no evidence the Committee ever sought, let alone received, a legal opinion as to the appropriateness of the terms of the proposed contract. The only law firm the Committee consulted

with concerning Grasso's proposed contract – Vedder, Price – was not asked to provide legal advice but, rather, was hired to serve as an independent compensation consultant. Moreover, although Ashen said he ultimately believed Vedder, Price recommended that the Committee approve the proposed contract, Vedder, Price vehemently denied ever making such a recommendation, and no recommendation to that effect appears in any of Vedder, Price's written reports or materials. Most Committee members recalled that Vedder, Price did not offer a recommendation as to whether or not to approve the proposed contract.

As for the NYSE's other consultants, Mercer simply performed a financial analysis and actuarial calculations pertaining to the contract proposal. While Mercer did conclude that the proposed contract presented a minimal financial benefit to the NYSE, Mischell did not opine on the appropriateness of the contract proposal, its terms, or the level of Grasso's compensation or benefits, nor was he ever asked to. Hewitt apparently played no role whatsoever in the renegotiation process, as the Committee chose instead to seek advice from an "independent" consultant (Vedder, Price).

Quite simply, the statements by Committee members at the August 7 Board meeting that the contract proposal had been signed off on by consultants and lawyers were not accurate. Like the misstatement that the entire $139.5 million payout was all "vested" and owing to Grasso, this misstatement was relied upon by many directors in deciding to approve the contract.

E. Failure to Condition Approval on Review of Written Contract

In light of the confusion and uncertainty surrounding the Board's August 7 consideration of the proposed contract, the Board could have tabled the issue for consideration under less hurried and confusing circumstances, or conditioned its approval of the proposed contract on a review of a written contract.

Clearly, there was a great deal of confusion and an unnecessary scramble to consider and approve the contract on that day. Because the matter was not on the agenda, non-Committee Board members had not had an opportunity to fully consider or vet the issue prior to the meeting, where they were clearly put on the spot by the Compensation Committee to decide the matter that day, with no notice. At the meeting, they received no materials or documentation regarding the contract proposal, other than the three-page handout, which amounted to little more than an itemized list of the elements which made up the $139.5 million payout. Because of the unnecessary scramble to get the issue before the Board that day, Mischell, who was fully versed in the terms of the contract, was unable to attend the meeting.

In light of these circumstances – the rushed manner in which the matter was brought before the Board and the obvious confusion in the room – it may have been prudent for the Board to have stepped back and delayed a decision on the proposal until it had time to gather and analyze all relevant facts and feel comfortable it was making an informed decision, and to reconvene the Board for consideration of a written contract for Grasso.

Ultimately, the Board delegated authority to negotiate and execute the contract in accordance with the terms approved at the August 7 Board meeting to McCall. McCall, however, signed the contract on August 27 without ever reading it in its entirety or understanding its key terms. As a result, issues regarding the $48 million in scheduled future payments to Grasso did not come to light until the contract had been signed.

VII. IMPACT ON THE NYSE CAUSED BY GRASSO'S EXCESSIVE LEVELS OF COMPENSATION AND BENEFITS

Grasso's excessive levels of compensation and benefits have negatively affected the NYSE in at least three fundamental ways. First, the large payouts of excess compensation and benefits have had a negative impact on the NYSE's financial capability to serve its purposes. Second, Grasso's excessive compensation and benefits have had a detrimental impact on the brand and goodwill of the NYSE. Finally, as a result of the excessive compensation and benefits, the NYSE has been required to spend resources that it otherwise would not have been required to spend had Grasso not been overcompensated.

A. Detrimental Effect on the NYSE's Financial Ability to Serve Its Purposes

The NYSE is a not-for-profit corporation that exists to provide a forum and facilities for its members to trade securities of companies that are listed on the NYSE.[233] To accomplish these goals, the NYSE must fund a wide variety of expenses including, for example, costs associated with maintaining the physical structure and facilities of the NYSE, operating its various electronic systems, providing regulatory oversight, and advertising and promotions relating to the NYSE.[234] Additionally, the NYSE also sets aside working capital to undertake capital improvements, such as new technology.

Thus, although the NYSE does not seek to maximize profits like a for-profit corporation, it must raise revenue and control expenses to fulfill its corporate purposes. Any unnecessary, unreasonable or wasteful expenses in material amounts necessarily hinder the NYSE's ability to properly use its funds and resources to serve its purposes, including for the benefit of its members, its listed companies or the investing public.

As noted in Section IV, Grasso received excess compensation in the amount of approximately $43.1 million, and received excess pension payments in the amount of approximately $70.1 million to $82.3 million, for a total amount in excess compensation and benefits paid to him of about $113.2 million to $125.4 million. These funds are clearly a material amount of money to the NYSE.

For example, in 2003, the NYSE was forced to pay over $51 million from its working capital to fund Grasso's SERP balance, which alone represented approximately 6% of the NYSE's working capital (as of the end of 2002). Additionally, in 2001, when Grasso received compensation totaling over $30 million, the NYSE's net income dropped over 50% from the prior year, falling from $72.9 million in 2000 to just $31.8 million in 2001.

In fact, the NYSE's net income has been steadily declining since 1998, while at the same time Grasso's annual compensation reached unprecedented levels. In addition, while Grasso's compensation was rising substantially, member fees also were increasing. A number of directors informed us that they and NYSE members were troubled when they learned of Grasso's large compensation and benefits because, at the same time the Board was increasing Grasso's annual compensation, the NYSE was raising its fees to members. The following chart shows the annual NYSE net income and total fees paid by members during Grasso's tenure and also lists Grasso's compensation each year.

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233 *See* NYSE Constitution at Art. I, Sec. 2.

234 *See, e.g.*, Consolidated Budget for 2003 at NYSE-014406.

NYSE NET INCOME AND MEMBER FEES VS. GRASSO INCOME[235]

Year	NYSE Net Income (In millions)	Total Fees Paid By Members[236] (In millions)	Grasso Total Compensation (In millions)
1995	$ 56.7	$ 268.7	$ 2.2
1996	74.4	291.1	3.0
1997	86.1	330.9	5.2
1998	101.3	377.6	6.0
1999	75.2	415.6	12.1
2000	72.9	468.3	26.8
2001	31.8	516.8	30.6
2002	28.1	507.9	12.0

Regardless of whether there is any direct correlation between member fees and Grasso's compensation levels, it is apparent that, had Grasso not been paid over $100 million in excessive compensation and benefits, the NYSE could have had the use of that money for other purposes that serve its interests in providing other benefits to its members, its listed companies, or the investing public. Indeed, aside from member fees, listed companies and investors also paid various fees during Grasso's tenure. One way or the other, having an additional $100 million in its coffers, or preventing an additional $100 million from being provided to Grasso, would have benefited the NYSE and its members, and may have benefited the NYSE's listed companies and the investing public as well.

B. Detrimental Effect on the NYSE's Brand and Goodwill

The NYSE creates value for its members by attracting (and maintaining) listed companies and attracting investors to buy and sell these companies' stocks through the NYSE. The NYSE brand and goodwill are important in the NYSE's success in accomplishing these and other institutional goals.

As a result of the excessive compensation to Grasso, many have called into question the NYSE's governance practices and other aspects of the NYSE's operations. The NYSE has also been the subject of inquiry on these issues from the SEC and has been widely criticized in the media and various public forums. According to a number of directors we interviewed, this has tended to erode the confidence and trust that listed companies and investors have in the NYSE, which harms the NYSE's brand and goodwill and, ultimately, can be detrimental to the NYSE's financial well being and its purpose as an organization.

Many directors and former directors have stated that in their opinion the overcompensation of Grasso has to some extent damaged the reputation, image and goodwill of the NYSE.

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235 *See* NYSE 049666, 049740, 049811, 049883, 049958, 050037, 050107.

236 The NYSE lists the following seven sources of revenue in its Annual Reports: (1) listing fees; (2) market data fees; (3) regulatory fees; (4) trading or transactional fees; (5) facility and equipment fees; (6) membership fees; and (7) investment and other income. All of these source, except listing fess and investment and other income are paid by members. The amounts in this column were calculated by taking the total revenue less listing fees and investment and other income. In 2002, the NYSE added a new line in its consolidated financial statements for data processing fees, which totaled $223,239,000 for 2001 and $224,575,000 for 2002; and which are not listed above.

C. Detrimental Effect on the NYSE as a Result of Having to Spend Its Resources on Matters Relating to Grasso's Overcompensation

As a result of Grasso's excessive compensation and benefits, the NYSE has been required to spend its resources dealing with the fallout from 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 responding to an inquiry from the SEC on matters relating to Grasso's compensation. None of these corporate resources would have been spent in the absence of the overcompensation.

Investigating Counsel

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Luke A. Connelly, Esq.
Gerald B. Song, Esq.
Kevin J. Behan, Paralegal

Exhibits

Exhibit 1

EXCESSIVE ANNUAL COMPENSATION AND PENSION BENEFIT OF RICHARD A. GRASSO

I. Annual Compensation (1995-2002)

Total Paid	*Proper* Compensation (Per Experts Johnson, Cook and Foley)	*Excess* 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)

Actual Pension (Accumulated/ Paid)	*Proper* Pension Per Experts (Accumulated/Paid)		*Excess* 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	$113,586,529/ $82,300,202	$101,386,529/ $70,100,202

TOTAL EXCESSIVE ANNUAL COMPENSATION AND ACCUMULATED PENSION

$144.5 MILLION TO $156.7 MILLION

Exhibit 2

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

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. Bernstein, 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

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. Lameo, 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

Exhibit 3

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

Exhibit 3

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

GRASSO OVERCOMPENSATION CHART

	Compensation Committee Analysis				Arkeen Analysis		Actual Gross Compensation							
Year	Comparator Group Median Used by Compensation Committee	Comparator Group Median Comp. Elec. By 15%*	NYSE Performance Factor	Gross Benchmark	Comparator Group (Median) 50th Percentile	Comparator Group (Median) 75th Percentile	Salary	ICP	LTIP	ELP	Payout for "Earnings" of ICP & LTIP Tranche	Special Bonus	Total	Overcompensation
1996			130%	$1,820,000*	$1,531,518	$1,663,870	$1,214,531	$600,000	$0	$0		$0	$2,114,531	-$305,469
1996	$3,400,000		130%	$3,420,000	$2,641,410	$2,871,114	$1,400,000	$1,600,000	$0	$0		$0	$3,000,000	-$420,000
1997	$2,200,000		130%	$2,860,000	$3,154,878	$3,672,212	$1,400,000	$3,600,000	$0	$0		$0	$5,000,000	$1,140,000
1998	$3,410,000		130%	$4,764,000	$3,316,780	$3,602,824	$1,400,000	$4,264,000	$700,000	$0		$0	$6,364,000	$1,600,000
1999	$5,444,667	$6,000,000	130%	$7,800,000	$3,961,612	$7,714,431	$1,400,000	$7,662,000	$144,000	$3,300,000	$700,000	$0	$13,206,000	$5,406,000
2000	$7,943,106	$7,133,210	150%	$11,697,907	$4,231,833	$8,978,000	$1,400,000	$12,011,000	$1,001,000	$3,000,000		$5,000,000	$22,412,000	$10,714,093
2001	$13,349,664	$12,014,678	130%	$15,618,082	$4,961,910	$9,041,667	$1,400,000	$15,100,000	$0	$3,000,000		$3,000,000	$22,500,000	$6,881,918
2002	$13,449,119	$13,104,207	115%	$15,070,238	$3,792,618	$5,139,710	$1,400,000	$7,000,000	$0	$1,833,333		$0	$10,233,333	$5,093,715
TOTALS	$53,353,782			$66,947,000	$33,995,113	$44,631,977	$11,914,531	$61,441,000	$1,410,000	$21,533,333	$700,000	$13,000,000	$97,818,864	$29,186,857

*In 1995, the Compensation Committee primarily based its decision for Grasso's total compensation on his contract, which provided for $1.4 million in salary and a target ICP award of $700,000.

Exhibit 4