

MERCURY GENERAL CORP  
Form DEF 14A  
April 05, 2005

**SCHEDULE 14A INFORMATION**

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

(Amendment No. )

Filed by the Registrant ..

Filed by a Party other than the Registrant ..

Check the appropriate box:

- .. Preliminary Proxy Statement
- .. **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- x Definitive Proxy Statement
- .. Definitive Additional Materials
- .. Soliciting Material under Rule 14a-12

**Mercury General Corporation**

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(Name of Registrant As Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement if Other Than the Registrant)

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- x No Fee required
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(1) Title of each class of securities to which transaction applies:

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(6) Amount Previously Paid:

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(7) Form, Schedule or Registration Statement No.:

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(8) Filing Party:

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(9) Date Filed:

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**4484 Wilshire Boulevard**  
**Los Angeles, California 90010**

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**NOTICE OF ANNUAL MEETING OF  
SHAREHOLDERS AND PROXY STATEMENT**

To The Shareholders of

Mercury General Corporation

Notice is hereby given that the Annual Meeting of Shareholders of MERCURY GENERAL CORPORATION (the Company) will be held at the Radisson Wilshire Plaza Hotel, 3515 Wilshire Boulevard, Los Angeles, California on May 11, 2005 at 10:00 a.m., for the following purposes:

1. To elect nine directors for the ensuing year to serve until the next Annual Meeting of Shareholders and until their successors are elected and have qualified;
2. To approve the Mercury General Corporation 2005 Equity Incentive Award Plan; and
3. To transact such other business as may properly come before the meeting.

The Board of Directors has fixed the close of business on March 15, 2005 as the record date for the determination of shareholders entitled to notice of and to vote at the meeting.

Accompanying this Notice of Annual Meeting is a proxy. WHETHER OR NOT YOU EXPECT TO BE AT THE MEETING, PLEASE COMPLETE, SIGN AND DATE THE ENCLOSED PROXY AND RETURN IT PROMPTLY.

BY ORDER OF THE BOARD OF DIRECTORS,

Judy A. Walters, *Secretary*

Los Angeles, California

April 4, 2005

**MERCURY GENERAL CORPORATION**

**4484 Wilshire Boulevard**

**Los Angeles, California 90010**

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**PROXY STATEMENT**

The Board of Directors of the Company is soliciting the enclosed proxy for use at the Annual Meeting of Shareholders of the Company to be held at 10:00 a.m. May 11, 2005, at the Radisson Wilshire Plaza Hotel, 3515 Wilshire Boulevard, Los Angeles, California. This Proxy Statement was first mailed to shareholders on or about April 4, 2005.

All shareholders who find it convenient to do so are cordially invited to attend the meeting in person. In any event, please complete, sign, date and return the proxy in the enclosed envelope.

A proxy may be revoked by written notice to the Secretary of the Company at any time prior to the voting of the proxy, or by executing a later proxy or by attending the meeting and voting in person. Unrevoked proxies will be voted in accordance with the instructions indicated in the proxies, or if there are no such instructions, such proxies will be voted FOR the election of the Board of Directors' nominees for director and FOR approval of the Mercury General Corporation 2005 Equity Incentive Award Plan (the "2005 Plan"). Shares represented by proxies that reflect abstentions or include "broker non-votes" will be treated as present and entitled to vote for purposes of determining the presence of a quorum.

Shareholders of record at the close of business on March 15, 2005 will be entitled to vote at the meeting. As of that date, 54,539,318 shares of common stock, without par value ("Common Stock"), of the Company were outstanding. Each share of Common Stock is entitled to one vote. A majority of the outstanding shares of the Company, represented in person or by proxy at the meeting, constitutes a quorum. The costs of preparing, assembling and mailing the Notice of Annual Meeting, Proxy Statement and proxy will be borne by the Company.

**VOTING**

In voting for the election of directors of the Company under the California General Corporation Law, if, prior to the commencement of voting, any shareholder has given notice of an intention to cumulate votes at the meeting, then all shareholders may cumulate their votes in the election of directors for any nominee if the nominee's name was placed in nomination prior to the voting. Under cumulative voting, each shareholder is entitled in the election of directors to one vote for each share held by the shareholder multiplied by the number of directors to be elected, and the shareholder may cast all such votes for a single nominee for director or may distribute them among any two or more nominees as the shareholder sees fit. If no such notice is given, there will be no cumulative voting. In the absence of cumulative voting, each shareholder may cast one vote for each share held multiplied by the number of directors to be elected, but may not cast more votes than the number of shares owned for any candidate and therefore a simple majority of the shares voting will elect all of the directors. Under either form of voting, the candidates receiving the highest number of votes, up to the number of directors to be elected, will be elected. Abstentions and broker non-votes will have no effect on the outcome of the election of directors.

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In the event of cumulative voting, the proxy solicited by the Board of Directors confers discretionary authority on the proxies to cumulate votes so as to elect the maximum number of the Board of Directors nominees. The proxy may not be voted for more than nine persons.

The affirmative vote of the majority of the shares present in person or represented by proxy and entitled to vote at the meeting is required to approve the 2005 Plan. Abstentions will be considered shares entitled to vote in

the tabulation of votes cast on this proposal, and will have the same effect as negative votes. Broker non-votes are not counted for the purpose of determining whether this matter is approved, and therefore will not have the effect of a negative vote with respect to the approval of the 2005 Plan.

The Board of Directors recommends that shareholders vote FOR election of the nine directors named in this Proxy Statement to serve until the next Annual Meeting of Shareholders and until their successors are elected and have qualified (see page 3) and FOR approval of the 2005 Plan (see page 15).

### Securities Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Stock as of March 15, 2005 by (i) each shareholder known by the Company to be a beneficial owner of more than 5% of any class of the Company's voting securities, (ii) each director and nominee for director of the Company, (iii) each executive officer named in the Summary Compensation Table below and (iv) the executive officers and directors of the Company as a group. The Company believes that, except as otherwise noted, each individual has sole investment and voting power with respect to the shares of Common Stock indicated as beneficially owned by such individual.

<u>Name of Beneficial Owner</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percentage of Outstanding Shares</u>
George Joseph	18,803,956(1)(2)(4)	34.5%
Director and Named Executive Officer		
Gloria Joseph	9,161,600(1)(3)	16.8%
Gabriel Tirador	57,272(4)	*
Named Executive Officer and Director		
Joanna Y. Moore	9,129(4)	*
Named Executive Officer		
Maria Fitzpatrick		*
Named Executive Officer		
Theodore R. Stalick	15,914(4)	*
Named Executive Officer		
Michael D. Curtius	16,073(4)	*
Director		
Charles E. McClung	27,500(5)	*
Director		
Donald P. Newell	4,500	*

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Director		
Donald R. Spuehler	2,000	*
Director		
Nathan Bessin	7,500	*
Director		
Bruce A. Bunner	2,500	*
Director		
All Executive Officers and Directors	19,128,526(4)	35.1%

\* Less than 1.0% of the outstanding Common Stock.

(1) As of October 7, 1985, George Joseph, Gloria Joseph and the Company entered into an agreement with respect to the ownership by George and Gloria Joseph of the Company's Common Stock. The agreement



- provides, among other things, that the shares of Common Stock held jointly were halved and transferred into the separate names of George Joseph and Gloria Joseph under their individual and independent control. In addition, Gloria Joseph has certain rights to have her shares registered for sale pursuant to the Securities Act of 1933, as amended. The registration rights provided to Gloria Joseph will terminate at such time as she ceases to hold at least 5% of the then outstanding shares of the Company's Common Stock.
- (2) George Joseph's business address is c/o Mercury General Corporation, 4484 Wilshire Boulevard, Los Angeles, California 90010. Includes 1,600 shares held in trust for the benefit of Mr. Joseph's daughter over which Mr. Joseph maintains dispositive and voting power.
  - (3) Gloria Joseph's business address is c/o Mercury General Corporation, 4484 Wilshire Boulevard, Los Angeles, California 90010.
  - (4) The table includes the following shares issuable upon exercise of options that are exercisable within 60 days from March 15, 2005: Gabriel Tirador, 54,350; Theodore Stalick, 15,500; all executive officers and directors as a group 147,450. The table also includes shares owned by the ESOP feature of the Company's profit sharing plan and allocated to the executive officers of the Company.
  - (5) Includes 27,500 shares held jointly with Mr. McClung's wife.

**PROPOSAL 1:**

**ELECTION OF DIRECTORS**

The Board of Directors of the Company has nominated and recommends for election as directors the following nine persons to serve until the next Annual Meeting of Shareholders and until their respective successors shall have been duly elected and shall qualify. All of the nominees are presently directors of the Company. The enclosed proxy will be voted in favor of the persons nominated unless otherwise indicated. If any of the nominees should be unable to serve or should decline to do so, the discretionary authority provided in the proxy will be exercised by the present Board of Directors to vote for a substitute or substitutes to be designated by the Board of Directors. The Board of Directors has no reason to believe that any substitute nominee or nominees will be required.

The table below indicates the position with the Company, tenure as director and age of each nominee as of March 15, 2005.

<u>Name</u>	<u>Position with the Company</u>	<u>Age</u>	<u>Director Since</u>
George Joseph	Chairman of the Board and Chief Executive Officer	83	1961(1)
Gabriel Tirador	President, Chief Operating Officer and Director	40	2003
Michael D. Curtius	Director	54	1996
Donald P. Newell	Director	67	1979(1)
Charles E. McClung	Director	90	1961(1)
Donald R. Spuehler	Director	70	1985
Nathan Bessin	Director	79	1991
Bruce A. Bunner	Director	71	1991
Richard E. Grayson	Director	75	1985

- (1) Date shown is the date elected a director of Mercury Casualty Company, a predecessor of the Company. Each of these individuals was elected a director of the Company in 1985.

Directors are elected at each annual meeting of the shareholders for one year and hold office until their successors are elected and qualified. Executive officers serve at the pleasure of the Board of Directors.



*George Joseph*, Chief Executive Officer of the Company and Chairman of its Board of Directors, has served as CEO and Chairman since 1961. He held the position of President of the Company between October 2000 and October 2001. He has more than 50 years experience in all phases of the property and casualty insurance business.

*Gabriel Tirador*, President and Chief Operating Officer of the Company, has served in that capacity since October 2001. He was the Company's Vice President and Chief Financial Officer from February 1998 until October 2001. From January 1997 to February 1998, he served as Vice President and Controller of the Automobile Club of Southern California. Prior to that, he served as the Company's assistant controller from March 1994 to December 1996. Mr. Tirador has over 15 years experience in the property and casualty insurance industry and is a certified public accountant.

*Michael D. Curtius* served as President and Chief Operating Officer of the Company from May 1995 until October 2000. Since October 2000, Mr. Curtius has served as an executive consultant to the Company. He served as Vice President and Chief Claims Officer of the Company from October 1987 until May 1995.

*Charles E. McClung* has been retired since January 2000. For more than the prior five years, Mr. McClung was the president and principal shareholder of McClung Insurance Agency, Inc., an insurance agency located in Montebello, California. Mr. McClung currently serves as chairman of the board of directors of that agency.

*Donald P. Newell* has been Senior Vice President and General Counsel of SCPIE Holdings Inc., an insurance holding company, since January 2001. For more than the prior five years, Mr. Newell was a partner of the law firm of Latham & Watkins in San Diego, California. Mr. Newell is also a director of SCPIE Holdings Inc.

*Donald R. Spuehler* has been retired since February 1995. From February 1992 through January 1995, Mr. Spuehler was of counsel to the law firm of O'Melveny & Myers of Los Angeles, California. For more than the prior five years, Mr. Spuehler was a partner of O'Melveny & Myers.

*Nathan Bessin* has been a Senior Partner of J. Arthur Greenfield & Co., Certified Public Accountants, for more than five years.

*Bruce A. Bunner* has been retired since February 2002. From January 1996 to February 2002, Mr. Bunner was President of Financial Structures, Limited, a Bermuda based insurance company and a subsidiary of Royal & SunAlliance Group plc. From April 1994 to April 1995, Mr. Bunner served as Director of External Affairs of Zurich Centre Advisors, Inc., a consulting company specializing in insurance and reinsurance risk arrangements. From January 1991 to April 1994, he served as Chairman of the Board of Centre Reinsurance Company of New York, a reinsurance company. Mr. Bunner was a partner in the firm of KPMG LLP, Certified Public Accountants, from 1974 to 1990, except during the period from 1983 to 1986 when he served as Insurance Commissioner of the State of California.

*Richard E. Grayson* has been retired since January 1995. For more than five years prior to such time, Mr. Grayson was Senior Vice President of Union Bank of Los Angeles, California and President and Director of Current Income Shares, Inc., a publicly held closed-end investment company.

#### **Recommendation of the Board of Directors**

The Board of Directors unanimously recommends that shareholders vote FOR the slate of nominees set forth above. Proxies solicited by the Board of Directors will be so voted unless shareholders specify otherwise on their proxy cards.

### Information Concerning the Board of Directors and Certain Committees Thereof

The Board of Directors held four meetings during the last fiscal year and is scheduled to meet quarterly during the current fiscal year. In 2004, each director attended at least 75% of the aggregate of all meetings held by the Board of Directors and all meetings held by all committees of the Board on which such director served. Directors are encouraged to attend in person each Annual Meeting of Shareholders. Seven directors attended the Annual Meeting of Shareholders in 2004. Directors are paid \$3,000 per quarter plus \$3,000 per meeting attended and reimbursement for their out-of-pocket expenses incurred in attending such meetings.

The Company has an Audit Committee established in accordance with requirements of Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The Audit Committee acts pursuant to a written charter adopted by the Board of Directors. The responsibilities of the Audit Committee include, among other things, selecting and engaging the Company's independent auditors, reviewing the scope of audit engagements, reviewing comment letters of such auditors and management's response thereto, approving professional services provided by such auditors, reviewing the independence of such auditors, reviewing any major accounting changes made or contemplated, considering the range of audit and non-audit fees and reviewing the adequacy of the Company's internal accounting controls. The Audit Committee currently consists of Nathan Bessin, Donald P. Newell and Donald R. Spuehler, with Nathan Bessin acting as Chairman of this Committee. The Board of Directors has determined that each member of the Audit Committee is independent and meets the financial literacy requirements of the listing standards under the New York Stock Exchange (the NYSE), that each member of the Audit Committee meets the enhanced independence standards established by the Securities and Exchange Commission (the SEC) and that Mr. Bessin qualifies as an audit committee financial expert as that term is defined in the rules and regulations established by the SEC. The Audit Committee held nine meetings in 2004. The chair of the Audit Committee receives an annual retainer of \$1,500, and each member of the Audit Committee receives \$2,500 per meeting attended plus reimbursement of their out-of-pocket expenses incurred in attending such meetings.

The Company has a Compensation Committee currently consisting of Donald R. Spuehler, Bruce A. Bunner and Richard E. Grayson, with Donald R. Spuehler acting as Chairman of this Committee. The Compensation Committee operates pursuant to a written charter adopted by the Board of Directors. The Compensation Committee held two meetings in 2004. The responsibilities of the Compensation Committee include, among other things, discharging the Board of Directors' responsibilities relating to compensation of the Company's executive officers, by designing in consultation with management and evaluating the compensation plans, policies and programs of the Company with respect to such executive officers, and administering the Company's stock option plan and Senior Executive Incentive Bonus Plan. The Board of Directors has determined that each member of the Compensation Committee is independent under the NYSE listing standards. Members of the Compensation Committee receive \$500 per meeting attended other than meetings held on the date of meetings of the entire Board of Directors plus reimbursement of their out-of-pocket expenses incurred in attending such meetings. The Chairman of the Compensation Committee also receives compensation based upon the number of additional hours spent on committee matters.

The Company has a Nominating/Corporate Governance Committee currently consisting of Donald P. Newell, Nathan Bessin and Donald R. Spuehler, with Donald P. Newell acting as Chairman of this Committee. The Nominating/Corporate Governance Committee operates pursuant to a written charter adopted by the Board of Directors. The Nominating/Corporate Governance Committee held three meetings in 2004. The responsibilities of the Nominating/Corporate Governance Committee include, among other things, identifying and recommending to the Board of Directors qualified candidates for nomination as directors of the Company, developing and recommending to the Board of Directors corporate governance principles applicable to the Company and overseeing the evaluation of the Board of Directors and management of the Company. The Board of Directors has determined that each member of the Nominating/Corporate Governance Committee is independent under the NYSE listing standards. The chair of the Nominating/Corporate Governance Committee receives an annual retainer of \$1,500 and \$1,500 per meeting attended, and each other member of the Nominating/Corporate Governance Committee receives \$1,000 per meeting attended plus, in each case, reimbursement of their out-of-pocket expenses incurred in attending such meetings.

### **Executive Sessions of Non-Management Directors**

The Board of Directors holds regularly scheduled executive sessions of its non-management directors, and at least annually schedules a meeting with only independent directors. In accordance with the Company's corporate governance guidelines, Donald P. Newell, Chairman of the Nominating/Corporate Governance Committee, will preside at these meetings. During 2004, the Board held four executive sessions of its non-management directors, including one such session with only independent directors.

### **Director Nomination Process**

*Director Qualifications.* The Nominating/Corporate Governance Committee has established certain criteria as guidelines in considering nominations to the Company's Board of Directors. The criteria include: (a) personal characteristics, including such matters as integrity, age, education, diversity of background and experience, absence of potential conflicts of interest with the Company or its operations, and the availability and willingness to devote sufficient time to the duties of a director of the Company; (b) experience in corporate management, such as serving as an officer or former officer of a publicly held company; (c) experience in the Company's industry and with relevant social policy concerns; (d) experience as a board member of another publicly held company; (e) academic expertise in an area of the Company's operations; and (f) practical and mature business judgment. The criteria are not exhaustive and the Nominating/Corporate Governance Committee and the Board of Directors may consider other qualifications and attributes that they believe are appropriate in evaluating the ability of an individual to serve as a member of the Board of Directors. The Nominating/Corporate Governance Committee's goal is to assemble a Board of Directors that brings to the Company a variety of perspectives and skills derived from high quality business and professional experience. In doing so the Nominating/Corporate Governance Committee also considers candidates with appropriate non-business backgrounds.

*Identification and Evaluation of Nominees for Directors.* The Board of Directors believes that, based on the Nominating/Corporate Governance Committee's knowledge of the Company's corporate governance principles and the needs and qualifications of the Board at any given time, the Nominating/Corporate Governance Committee is best equipped to select nominees that will result in a well-qualified and well-rounded board of directors. Accordingly, it is the policy of the Nominating/Corporate Governance Committee not to accept unsolicited nominations from shareholders. In making its nominations, the Nominating/Corporate Governance Committee identifies nominees by first evaluating the current members of the Board willing to continue their service. Current members with qualifications and skills that are consistent with the Nominating/Corporate Governance Committee's criteria for Board service are re-nominated. As to new candidates, the Nominating/Corporate Governance Committee will generally poll the Board members and members of management for recommendations. The Nominating/Corporate Governance Committee may also review the composition and qualification of the boards of directors of the Company's competitors, and may seek input from industry experts or analysts. The Nominating/Corporate Governance Committee reviews the qualifications, experience and background of the candidates. Final candidates are interviewed by the independent directors and executive management. In making its determinations, the Nominating/Corporate Governance Committee evaluates each individual in the context of the Board as whole, with the objective of assembling a group that can best represent shareholder interests through the exercise of sound judgment. After review and deliberation of all feedback and data, the Nominating/Corporate Governance Committee makes its recommendation to the Board of Directors. Historically, the Board of Directors has not relied on third-party search firms to identify director nominees. The Nominating/Corporate Governance Committee may in the future choose to engage third-party search firms in situations where particular qualifications are required or where existing contacts are not sufficient to identify an appropriate candidate.

Each of the nominees for election as director at the 2005 Annual Meeting of Shareholders were elected at the Annual Meeting of Shareholders held in 2004. Each of the nominees for election are recommended by the Nominating/Corporate Governance Committee to stand for reelection.

### **Director Independence**

The Company's Board of Directors currently consists of nine directors. The Board has determined that each of Nathan Bessin, Bruce A. Bunner, Richard E. Grayson, Charles E. McClung, Donald P. Newell and Donald R. Spuehler has no material relationship with the Company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company) and is independent under the NYSE listing standards. In making its determination, the Board considered transactions and relationships between each director (and any member of his or her immediate family) and the Company and its subsidiaries and relationships between the directors or their affiliates and members of the Company's senior management personnel and their affiliates.

### **Shareholder Communication with Directors**

Shareholders may, at any time, communicate in writing with any particular director, or the non-management directors as a group, by sending such written communication to Mercury General Corporation - Non-Management Directors, P.O. Box 36662, Los Angeles, California 90036. Copies of written communications received at such address will be directed to the relevant director or the non-management directors as a group.

### **Code of Business Conduct and Ethics**

The Company has established a Code of Business Conduct and Ethics that applies to its officers, directors and employees. The Code of Business Conduct and Ethics contains general guidelines for conducting the business of the Company consistent with the highest standards of business ethics, and is intended to qualify as a code of ethics within the meaning of Section 406 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder and as a code of business conduct and ethics within the meaning of the NYSE listing standards.

### **Corporate Governance Documents**

The Company's corporate governance documents, including the Corporate Governance Guidelines, Code of Business Conduct and Ethics, Audit Committee Charter, Compensation Committee Charter and Nominating/Corporate Governance Committee Charter, are available, free of charge, on the Company's website at [www.mercuryinsurance.com](http://www.mercuryinsurance.com). Please note, however, that the information contained on the website is not incorporated by reference in, or considered part of, this Proxy Statement. The Company will also provide copies of these documents, free of charge, to any shareholder upon written request to the Company's Chief Financial Officer, Mercury General Corporation, 4484 Wilshire Boulevard, Los Angeles, California 90010.

## EXECUTIVE COMPENSATION

## Summary Compensation Table

The following table sets forth, for the periods indicated, the compensation paid by the Company to its Chief Executive Officer and each of its four most highly compensated executive officers other than the Chief Executive Officer.

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation
		Salary	Bonus	All Other Compensation (1)	Securities Underlying Options
George Joseph Chairman and Chief Executive Officer	2004	\$ 676,363	\$ 1,663,067	\$ 23,442	
	2003	611,982	795,821	23,807	
	2002	582,840	144,286	29,139	
Gabriel Tirador President, Chief Operating Officer and Director	2004	\$ 450,000	\$ 1,381,470	\$ 29,942	
	2003	374,500	657,539	22,307	
	2002	350,000	114,584	9,639	
Joanna Y. Moore Vice President and Chief Claims Officer	2004	\$ 219,271	\$ 409,494	\$ 9,013	
	2003	212,694	209,208	9,807	
	2002	199,522	58,517	9,639	
Maria Fitzpatrick (2) Vice President and Chief Information Officer	2004	\$ 246,355	\$ 233,593	\$ 3,442	10,000
	2003				
	2002				
Theodore R. Stalick Vice President and Chief Financial Officer	2004	\$ 227,263	\$ 234,375	\$ 9,942	7,500
	2003	207,538	133,750	9,807	
	2002	180,330	38,750	9,639	

- (1) Amounts shown include the Company's contributions under its profit sharing plan for Company employees, the Company's matching contributions under a 401(k) option to the profit sharing plan, the year-end value of stock contributed under the ESOP feature of the profit sharing plan and, for George Joseph and Gabriel Tirador only, director fees. Those amounts, expressed in the same order as above, for the Named Executive Officers for 2004 are as follows: George Joseph \$2,167, \$0, \$1,275, \$20,000; Gabriel Tirador \$2,167, \$6,500, \$1,275, \$20,000; Joanna Moore \$2,167, \$5,571, \$1,275; Maria Fitzpatrick \$2,167, \$0, \$1,275; and Theodore Stalick \$2,167, \$6,500, \$1,275.
- (2) Ms. Fitzpatrick joined the Company in February 2004. The salary amount represents salary actually earned by Ms. Fitzpatrick during 2004, based on an annual rate of \$275,000.

## Option Grants In Last Fiscal Year

The following table provides information with respect to stock options granted to each of the Named Executive Officers during 2004.

Number	Individual Grants	Potential Realizable Value
		At Assumed Annual Rates



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Name	of Securities	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price (\$/SH)	Expiration Date	of Stock Price Appreciation	
	Underlying Options Granted (1)				for Option Term (2)	
						5%
Maria Fitzpatrick	10,000	18.3%	\$ 51.43	10/29/2014	\$ 323,440	\$ 819,662
Theodore R. Stalick	7,500	13.8%	51.43	10/29/2014	242,580	614,746

(1) These options become exercisable in five equal installments on the first through fifth anniversary of the grant date.

(2) The assigned rates of growth were selected by the SEC for illustrative purposes only and are not intended to predict or forecast future stock prices.

### Aggregated Option Exercises in Last Fiscal Year and FY-End Option Value Table

The Company has a stock option plan for key executives. The following table sets forth information regarding the grant and exercise of stock options during 2004 by the named executive officers and the value of unexercised stock options as of December 31, 2004.

Name	Shares Acquired on Exercise	Value Realized(1)	Number of Unexercised Options at		Value of Unexercised In-the-Money Options at	
			December 31, 2004		December 31, 2004(2)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Gabriel Tirador	2,150	\$ 75,116	52,350	22,000	\$ 1,182,199	\$ 439,852
Joanna Y. Moore	14,920	510,492				
Maria Fitzpatrick				10,000		84,900
Theodore R. Stalick			15,500	10,500	396,236	130,545

(1) Fair market value of underlying securities at exercise minus the exercise price

(2) The value of unexercised options represents the difference between the closing price of the Common Stock on December 31, 2004, which was \$59.92 per share, and the exercise price of the options.

George Joseph, the Chief Executive Officer and principal shareholder of the Company, has not been granted options under the Company's plan.

### Equity Compensation Plan Information

The following table sets forth information regarding all of the Company's equity compensation plans as of December 31, 2004.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under
			Equity Compensation Plans (excluding securities reflected in column (a))
			reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	506,665	\$ 36.118	4,583,600
Equity compensation plans not approved by security holders(1)	N/A	N/A	N/A
<b>Total</b>	<b>506,665</b>	<b>\$ 36.118</b>	<b>4,583,600</b>

- (1) The Company maintains no equity compensation plans not approved by its securities holders that are not intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code. The Company maintains a Profit Sharing Plan that includes an employee stock ownership plan that covers substantially all employees and is intended to meet the qualification requirements of Section 401(a) of the Internal Revenue Code.

#### **Senior Executive Incentive Bonus Plan**

The Company's Board of Directors adopted a Senior Executive Incentive Bonus Plan (the "Senior Plan") on March 23, 1998 and reapproved the Senior Plan on January 31, 2003, which was approved by the Company's shareholders at the Annual Meeting of Shareholders held on May 13, 1998 and again at the Annual Meeting of Shareholders held on May 14, 2003. Under the Senior Plan, designated executive officers of the Company are eligible to receive bonus payments. The Senior Plan provides an incentive for senior executives to perform superior work, ties the incentives of such executives to those of the Company and its shareholders, and enables the Company to attract and retain highly qualified senior executives. The Company believes that the bonuses payable by the Company under the Senior Plan to its senior executives will be fully deductible for federal income tax purposes. As discussed under "Report of the Compensation Committee" below, Messrs. Joseph and Tirador were the only participants in 2004.

## REPORT OF THE COMPENSATION COMMITTEE

The duty of the Compensation Committee, pursuant to its Charter approved by the Board of Directors of the Company, is to discharge the Board's responsibilities relating to compensation of the Company's executive officers, by designing in consultation with management and evaluating the compensation plans, policies and programs of the Company with respect to such executive officers. The Compensation Committee also reviews in detail with the Board its recommendations of the factors and criteria upon which the Company's Chief Executive Officer's compensation is based and the level of compensation recommended.

Historically, pursuant to Board policy embodied in a standing resolution adopted at the Board's January 31, 1986 meeting, Mr. Joseph, then President and Chief Executive Officer of the Company, was given authority for hiring, promotion and the establishment of compensation for all other executive officers. Mr. Joseph retains this authority and with the President, Gabriel Tirador, annually reviews compensation and responsibilities of all other executive officers. Mr. Joseph has periodically reported key executive appointments and key decisions as to executive compensation to the Board and this information has been recorded in Board minutes from time to time.

The compensation levels and the overall compensation policy of the Company adopted by Mr. Joseph for all executive officers other than the Chief Executive Officer in effect for 2004 has been reviewed by the Compensation Committee with Mr. Joseph and Mr. Tirador. The Compensation Committee expects, as described in this report, that compensation of such executive officers will continue to be governed by such policy in 2005.

The Compensation Committee's policy is to determine salary increases for the Chief Executive Officer on a calendar year basis, concurrent with the performance period under the Senior Plan. Mr. Tirador's salary will also be determined on a calendar year basis concurrent with the performance period under the Senior Plan. The Compensation Committee has established a bonus formula for Messrs Joseph and Tirador as the sole Covered Executives under the Senior Plan, pursuant to which a bonus will be accrued for 2005 and paid after its calculation in 2006. Other executive officers receive salary increases at various times during the year, normally on the anniversary of their date of hire or major change of responsibility.

The basic strategy of the Company is that executive officers subject to Mr. Joseph's review should receive compensation and benefits commensurate with responsibilities and competitive with compensation paid to executives in like positions, as determined by him and/or the President based on their experience in the insurance industry and the Company's continuing surveillance of industry and general business practice.

In addition to salary and benefits, executive officers receive a substantial portion of their annual total compensation through bonuses based on individual performance and underwriting results and revenues. Salaries for executive officers are reviewed on a yearly basis. Salary increases take into account the same factors used with respect to bonuses—underwriting results and revenues and the successful attainment of goals set by the Chief Executive Officer and the President. Also taken into account are factors reflecting the ability of the individual executive to manage direct and indirect costs as the volume of business varies, turnover and morale with respect to employees under the executive's management, the expense of adjusting claims and prevailing salaries in the industry, with all factors taken into account over appropriate cycles of rates, premiums and profitability of the Company and the industry.

In addition to the nondiscriminatory tax-qualified profit sharing plan and the tax deferred Section 401(k) option to that plan maintained for employees, the Company maintains a stock option plan under which key employees are granted options at 100% of fair market value of Company stock on the date of grant. The overall policy of the Company, as approved by the Board and Compensation Committee and embodied in awards made by the Compensation Committee, is that key officers and managers responsible for success of the Company should be granted options in Company stock under that program. Grants were made to optionees who were not Named Executive Officers in 2004 under the

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program on 37,000 shares of the Company's common stock. Grants were made to Named Executive Officers in 2004 on 17,500 shares of the Company's common stock. All grants were made at 100% of fair market value of Company stock on the date of grant.

*The Chief Executive Officer*

After study and discussions with management, under the policies established by the Compensation Committee, a modest increase for Mr. Joseph in base compensation was approved effective January 1, 2005.

Additional compensation paid to Mr. Joseph in 2004 included director fees and a bonus equivalent to one-half month's pay which is the level of bonus awarded to all employees. A bonus for 2004 was accrued for Mr. Joseph under the Senior Plan pursuant to the formula adopted by the Compensation Committee, and the bonus will be paid in 2005 after calculation. As described earlier, the Compensation Committee has established the bonus formula for Mr. Joseph under the Senior Plan for a bonus to be accrued in 2005 and paid after calculation in 2006. Mr. Joseph does not hold any options under the Company's stock option plan.

The Compensation Committee has reviewed compensation of executives for the years 2003 and 2004 in certain selected national and comparable insurance companies as publicly available in proxy statements and executive compensation analyses. The Compensation Committee has also reviewed summaries of executive compensation practices in financial and non-insurance companies available in various published studies. Taking into account this and other information, the Compensation Committee believes that the level of Mr. Joseph's compensation is entirely reasonable.

*Internal Revenue Code Section 162(m)*

The Compensation Committee has considered the potential impact of Section 162(m) (the Section ) of the Internal Revenue Code adopted under the federal Revenue Reconciliation Act of 1993. The Section disallows a tax deduction for any publicly-held corporation for individual compensation exceeding \$1 million in any taxable year for any of the named executive officers, other than compensation that is performance-based under a plan approved by the shareholders of the corporation. The Compensation Committee has concluded that the Senior Plan and the 1995 Stock Option Plan of Mercury General Corporation meet the requirements for a performance-based plan under the regulation interpreting the Section and that the Mercury General Corporation 2005 Equity Incentive Award Plan, if approved by the shareholders at the Annual Meeting, will meet such requirements. Since targeted compensation aside from compensation under such plans is well below the \$1 million threshold, the Compensation Committee has concluded that the Section should not reduce the tax deductions available to the Company and that no changes to the Company's compensation program were needed in this regard.

January 28, 2005

The Compensation Committee

Donald R. Spuehler, Chair

Bruce A. Bunner

Richard E. Grayson

**Compensation Committee Interlock and Insider Participation in Compensation Decisions**

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No member of the Company's Compensation Committee is a current or former officer or employee of the Company or any of its subsidiaries, and no current executive officer served as a member of the board of directors or compensation committee of any other entity that has or had one or more executive officers serving as a member of the Company's Board of Directors or Compensation Committee during 2004.

**REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS**

The Audit Committee of the Mercury General Corporation Board of Directors is composed of three independent directors as required by the listing standards of the New York Stock Exchange and operates under a written charter adopted by the Board of Directors. The members of the Audit Committee are Nathan Bessin (Chair), Donald R. Spuehler and Donald P. Newell.

Management is responsible for the Company's internal controls and the financial reporting process. The independent accountants, KPMG LLP, are responsible for performing an independent audit of the Company's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America, for performing an independent audit of the Company's internal control over financial reporting in accordance with standards of the Public Company Accounting Oversight Board (United States) and for issuing reports thereon. The Audit Committee's responsibility is to monitor and oversee these processes.

In this context, the Audit Committee has met and held discussions with management and the independent accountants. Management represented to the Audit Committee that the Company's consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, and the Audit Committee has reviewed and discussed the consolidated financial statements with management and the independent accountants. The Audit Committee discussed with the independent accountants matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees).

The Company's independent accountants also provided to the Audit Committee the written disclosures required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and the Audit Committee discussed with the independent accountants that firm's independence. The Audit Committee also considered whether the provision of financial information systems design and other non-audit services by the independent accountants is compatible with their independence.

Based upon the Audit Committee's discussion with management and the independent accountants and the Audit Committee's review of the representation of management and the report of the independent accountants to the Audit Committee, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission.

March 9, 2005

The Audit Committee

Nathan Bessin, Chair

Donald R. Spuehler

Donald P. Newell



**Audit Fees for Fiscal 2003 and 2004**

The aggregate fees billed to the Company by KPMG LLP, the Company's independent accountants, for the fiscal years ended December 31, 2003 and 2004 are as follows:

	<u>2003</u>	<u>2004</u>
Audit Fees(1)	\$ 432,500	\$ 1,144,213
Audit Related Fees(2)	16,000	32,788
Tax Fees		
All Other Fees		

- (1) Audit Fees consists of the audit of the Company's annual financial statements included in the Company's Annual Report on Form 10-K and Annual Report to Shareholders, review of interim financial statements included in the Company's Quarterly Reports on Form 10-Q and services that are normally provided by the independent auditors in connection with statutory and regulatory filings or engagements for those fiscal years. In 2004, Audit Fees also includes the audit of management's assessment of internal control over financial reporting. The fees associated with this audit amounted to \$607,500.
- (2) Audit-Related Fees consists primarily of fees associated with the Company's employee benefits plan.

The Audit Committee has considered whether the provision of non-audit services is compatible with maintaining the independence of KPMG LLP, and has concluded that the provision of such services is compatible with maintaining the independence of the Company's auditors.

Representatives of KPMG LLP will be present at the Annual Meeting, will be available to respond to questions and may make a statement if they so desire.

**Selection of Independent Auditors**

The Audit Committee is responsible to select the independent auditors to audit the Company's annual financial statements included in the Company's Annual Report on Form 10-K. The Audit Committee selected KPMG LLP during 2004 as independent auditors for that year, and has selected KPMG LLP to review the interim financial statements of the Company for the first three quarters of 2005. The Audit Committee expects to select the independent auditors of the Company's annual financial statements for 2005 during the next few months, as part of its normal selection process.

**Audit Committee Policy Regarding Pre-Approval of Audit and Permissible Non-Audit Services of the Company's Independent Auditors**

The Company's Audit Committee has established a policy that all audit and permissible non-audit services provided by the independent auditors will be pre-approved by the Audit Committee. These services may include audit services, audit-related services, tax services and other services. The Audit Committee considers whether the provision of each non-audit service is compatible with maintaining the independence of the Company's auditors. Pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The independent auditors and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditors in accordance with this pre-approval, and the fees for the services performed to date.



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**PERFORMANCE GRAPH**

The graph below compares the cumulative total shareholder return on the shares of Common Stock of the Company (MCY) for the last five years with the cumulative total return on the Standard and Poor's 500 Index and a peer group comprised of selected property and casualty insurance companies over the same period (assuming the investment of \$100 in the Company's Common Stock, the S&P 500 Index and the peer group at the closing price on December 31, 1999 and the reinvestment of all dividends).

**Comparative Five-Year Cumulative Total Returns Mercury General Corporation,  
a Peer Group Index and the S&P 500 Index**

	Fiscal Year Ended					
	1999	2000	2001	2002	2003	2004
Mercury General Corporation	\$ 100.00	\$ 204.21	\$ 209.07	\$ 185.03	\$ 236.47	\$ 313.01
Peer Group	100.00	145.24	142.36	133.96	163.33	178.91
S&P 500 Composite Index	100.00	90.89	80.09	62.39	80.29	89.02

The peer group consists of those companies that are Ace Limited, Alleghany Corp, Allmerica Financial, Allstate Corporation, American Financial Group, Berkley W.R., Berkshire Hathaway, CNA Financial, Chubb Corp, Cincinnati Financial, Everest Re Group, Ltd, Fidelity Nat'l Fin, HCC Insurance Holdings, Mercury General Corporation, Markel Corporation, Ohio Casualty, Old Republic International, PMI Group, Inc., Partner Re, Ltd., Progressive Corp, RLI Corporation, Safeco Corp, St. Paul Travelers, Selective Insurance, TransAtlantic Holdings, 21st Century Industries and XL Capital Ltd.

**PROPOSAL 2:**

**APPROVAL OF THE MERCURY GENERAL CORPORATION**

**2005 EQUITY INCENTIVE PLAN**

Shareholders are requested in this Proposal 2 to consider and approve the Mercury General Corporation 2005 Equity Incentive Award Plan (the 2005 Plan ) as a replacement for the Company 's 1995 Stock Option Plan. The Board of Directors adopted, subject to shareholder approval, the 2005 Plan for non-employee directors and employees of the Company and its subsidiaries on January 28, 2005. The 2005 Plan will become effective upon shareholder approval at the 2005 Annual Meeting of Shareholders.

The Board believes that the 2005 Plan will promote the success and enhance the value of the Company by linking the personal interest of participants to those of Company shareholders and by providing participants with an incentive for outstanding performance.

The 2005 Plan provides for the grant of both incentive stock options and nonqualified stock options, restricted stock, stock appreciation rights, performance shares, performance stock units, dividend equivalents, stock payments, deferred stock, restricted stock units, other stock-based awards, and performance-based awards to eligible individuals. A summary of the principal provisions of the 2005 Plan is set forth below. The summary is qualified by reference to the full text of the 2005 Plan, which is attached as Annex A to this Proxy Statement.

**Administration**

The Compensation Committee of the Board of Directors will administer the 2005 Plan. The Compensation Committee may delegate to a committee of one or more members of the Board the authority to grant or amend awards to participants other than senior executives of the Company who are subject to Section 16 of the Securities Exchange Act of 1934, as amended (the Exchange Act ), or employees who are covered employees within the meaning of Section 162(m) ( Section 162(m) ) of the Internal Revenue Code (the Code ). The Compensation Committee includes at least two directors, each of whom qualifies as a non-employee director pursuant to Rule 16b-3 of the Exchange Act, and an outside director pursuant to Section 162(m).

The Compensation Committee will have the exclusive authority to administer the 2005 Plan, including the power to determine eligibility, the types and sizes of awards, the price and timing of awards and the acceleration or waiver of any vesting restriction, provided that the Compensation Committee will not have the authority to accelerate vesting or waive the forfeiture of any performance-based awards.

**Eligibility**

Persons eligible to participate in the 2005 Plan include non-employee members of the Board and all of the employees of the Company and its subsidiaries, as determined by the Compensation Committee.

**Limitation on Awards and Shares Available**

The maximum number of shares of Common Stock available for issuance under the 2005 Plan is 5,400,000. To the extent that an award terminates, expires or lapses for any reason, any shares subject to the award may be used again for new grants under the 2005 Plan. In addition, shares tendered or withheld to satisfy the grant or exercise price or any tax withholding obligation may be used for grants under the 2005 Plan. Shares issued in assumption of, or in substitution for, any outstanding awards of any entity acquired in any form of combination by the Company or any of its subsidiaries will not be counted against the shares available for issuance under the 2005 Plan. Notwithstanding the foregoing, no shares will become available (a) upon the cancellation of existing awards or any similar transactions following the tenth anniversary of shareholder approval of the 2005 Plan or (b) if the return of shares would require additional shareholder approval of the 2005 Plan pursuant to applicable

rules of the New York Stock Exchange. The payment of dividend equivalents in conjunction with outstanding awards will not be counted against the shares available for issuance under the 2005 Plan. The shares of Common Stock covered by the 2005 Plan may be treasury shares, authorized but unissued shares, or shares purchased in the open market.

The maximum number of shares of Common Stock that may be subject to one or more awards to a participant pursuant to the 2005 Plan during any one-year period shall be 100,000.

## Awards

The 2005 Plan provides for the grant of incentive stock options and nonqualified stock options, restricted stock, stock appreciation rights, performance shares, performance stock units, dividend equivalents, stock payments, deferred stock, restricted stock units, other stock-based awards and performance-based awards. No determination has been made as to the types or amounts of awards that will be granted to specific individuals pursuant to the 2005 Plan. Information regarding stock option grants to the Named Executive Officers for the fiscal year ended December 31, 2004 is set forth in the section of this Proxy Statement entitled Executive Compensation.

Stock options, including incentive stock options, as defined under Section 422 of the Code, and nonqualified stock options may be granted pursuant to the 2005 Plan. The option exercise price of all stock options granted pursuant to the 2005 Plan will be at least 100% of the fair market value of the Common Stock on the date of grant. Stock options may be exercised as determined by the Compensation Committee, but in no event after the tenth anniversary date of grant. The aggregate fair market value of the shares with respect to which options intended to be incentive stock options are exercisable for the first time by an employee in any calendar year may not exceed \$100,000, or such other amount as the Code provides.

Upon the exercise of a stock option, the purchase price must be paid in full in either cash or its equivalent, by delivering a promissory note bearing interest at no less than such rate as shall then preclude the imputation of interest under the Code, or by tendering previously acquired shares of Common Stock with a fair market value at the time of exercise equal to the exercise price (provided such shares have been held for such period of time as may be required by the Compensation Committee in order to avoid adverse accounting consequences) or other property acceptable to the Compensation Committee (including through the delivery of a notice that the participant has placed a market sell order with a broker with respect to shares then issuable upon exercise of the option, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to the Company in satisfaction of the option exercise price, provided that payment of such proceeds is then made to the Company upon settlement of such sale). However, no participant who is a member of the Board or an executive officer of the Company will be permitted to pay the exercise price of an option in any method in violation of Section 13(k) of the Exchange Act.

Restricted stock may be granted pursuant to the 2005 Plan. A restricted stock award is the grant of shares of Common Stock at a price determined by the Compensation Committee (including zero) that is nontransferable and may be subject to substantial risk of forfeiture until specific conditions are met. Conditions may be based on continuing employment or achieving performance goals. During the period of restriction, participants holding shares of restricted stock may have full voting and dividend rights with respect to such shares. The restrictions will lapse in accordance with a schedule or other conditions determined by the Compensation Committee.

A stock appreciation right (an SAR) is the right to receive payment of an amount equal to the excess of the fair market value of a share of Common Stock on the date of exercise of the SAR over the fair market value of a share of Common Stock on the date of grant of the SAR.

The other types of awards that may be granted under the 2005 Plan include performance shares, performance stock units, dividend equivalents, deferred stock, restricted stock units, and other stock-based awards.

### **Changes in Capital Structure**

In the event of a stock dividend, stock split, combination or exchange of shares, merger, consolidation, spin-off, recapitalization, distribution of assets or any other corporate event affecting the Common Stock or the share price of the Common Stock in a manner that causes dilution or enlargement of benefits or potential benefits under the 2005 Plan, then the Compensation Committee may make proportionate adjustments to: (i) the aggregate number of, and types of, shares of stock subject to the 2005 Plan, (ii) the terms and conditions of any outstanding awards (including any applicable performance targets) and (iii) the grant or exercise price for any outstanding awards. In addition, in such a case or in the event of any unusual or nonrecurring transactions or events affecting the Company or of changes in applicable laws, the Compensation Committee, may, subject to the terms of the 2005 Plan, take any of the following actions if it determines that such action is appropriate in order to prevent the dilution or enlargement of benefits or potential benefits intended to be made available under the 2005 Plan or with respect to any award: (i) provide for either the termination, purchase or replacement of the awards, (ii) provide that the awards shall be assumed by the successor or survivor corporation, or a parent or subsidiary thereof, or shall be substituted for by similar awards covering the stock of the successor or survivor corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number and kind of shares and prices, (iii) make adjustments in the number and type of shares of stock (or other securities or property) subject to outstanding awards and/or in the terms and conditions of (including the exercise price), and the criteria included in, outstanding awards which may be granted in the future, (iv) provide for the acceleration of vesting or exercisability of the awards and (v) provide that the awards cannot vest or be exercised after the event that triggers the action.

### **Amendment and Termination**

The Compensation Committee, subject to approval of the Board, may terminate, amend, or modify the 2005 Plan at any time; provided, however, that shareholder approval must be obtained for any amendment to the extent necessary or desirable to comply with any applicable law, regulation or stock exchange rule, to increase the number of shares available under the 2005 Plan, to permit the Compensation Committee to grant options with an exercise price below fair market value on the date of grant, to extend the exercise period for an option beyond ten years from the date of grant or to allow a material increase in the benefits or change the eligibility requirements under the 2005 Plan. In addition, without approval of the Company's shareholders, no option may be amended to reduce the per share exercise price of the shares subject to such option below the per share exercise price as of the date the option was granted and, except to the extent permitted by the 2005 Plan in connection with changes in the Company's capital structure, no option may be granted in exchange for, or in connection with, the cancellation or surrender of an option having a higher per share exercise price.

In no event may an award be granted pursuant to the 2005 Plan on or after January 28, 2015.

### **Securities Law**

The 2005 Plan is intended to conform to the extent necessary with all provisions of the Securities Act and the Exchange Act, and any and all regulations and rules promulgated by the Securities and Exchange Commission thereunder, including without limitation Rule 16b-3. The 2005 Plan will be administered, and options will be granted and may be exercised, only in such a manner as to conform to such laws, rules and regulations. To the extent permitted by applicable law, the 2005 Plan and options and other Awards granted thereunder shall be deemed amended to the extent necessary to conform to such laws, rules and regulations.

### **Federal Income Tax Consequences**



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The tax consequences of the 2005 Plan under current federal law are summarized in the following discussion which deals with the general tax principles applicable to the 2005 Plan, and is intended for general information only. Alternative minimum tax and state and local income taxes are not discussed. Tax laws are complex and subject to change and may vary depending on individual circumstances and from locality to locality. The tax information summarized is not tax advice.

*Nonqualified Stock Options.* For federal income tax purposes, an optionee generally will not recognize taxable income on the grant of a nonqualified stock option (an NQSO) under the 2005 Plan, but upon the exercise of an NQSO will recognize ordinary income, and the Company generally will be entitled to a deduction. The amount of income recognized (and the amount generally deductible by the Company) generally will be equal to the excess, if any, of the fair market value of the shares at the time of exercise over the aggregate exercise price paid for the shares, regardless of whether the exercise price is paid in cash or in shares or other property. An optionee's basis for the stock for purposes of determining his or her gain or loss upon a subsequent disposition of the shares generally will be the fair market value of the stock on the date of exercise of the NQSO, and any subsequent gain or loss will generally be taxable as capital gains or losses.

*Incentive Stock Options.* An optionee generally will not recognize taxable income upon either the grant or exercise of an Incentive Stock Option (an ISO); however, the amount by which the fair market value of the shares at the time of exercise exceeds the exercise price will be an item of tax preference for the optionee for purposes of the alternative minimum tax. Generally, upon the sale or other taxable disposition of the shares of the Common Stock acquired upon exercise of an ISO, the optionee will recognize income taxable as capital gains in an amount equal to the excess, if any, of the amount realized in such disposition over the option exercise price, provided that no disposition of the shares has taken place within either (a) two years from the date of grant of the ISO or (b) one year from the date of exercise. If the shares of Common Stock are sold or otherwise disposed of before the end of the one-year and two-year periods specified above, the difference between the ISO exercise price and the fair market value of the shares on the date of exercise generally will be taxable as ordinary income; the balance of the amount realized from such disposition, if any, generally will be taxed as capital gain. If the shares of Common Stock are disposed of before the expiration of the one-year and two-year periods and the amount realized is less than the fair market value of the shares at the date of exercise, the optionee's ordinary income generally is limited to excess, if any, of the amount realized in such disposition over the option exercise price paid. The Company (or other employer corporation) generally will be entitled to a tax deduction with respect to an ISO only to the extent the optionee has ordinary income upon sale or other disposition of the shares of Common Stock.

*Stock Appreciation Rights.* No taxable income is generally recognized upon the receipt of a stock appreciation right (an SAR), but upon exercise of the SAR the fair market value of the shares (or cash in lieu of shares) received generally will be taxable as ordinary income to the recipient in the year of such exercise. The Company generally will be entitled to a compensation deduction for the amount the recipient recognizes as ordinary income.

*Restricted Stock and Deferred Stock.* An employee to whom restricted or deferred stock is issued generally will not recognize taxable income upon such issuance and the Company generally will not then be entitled to a deduction, unless, in the case of restricted stock, an election is made under Section 83(b) of the Code. However, when restrictions on shares of restricted stock lapse, such that the shares are no longer subject to a substantial risk of forfeiture, the employee generally will recognize ordinary income and the Company generally will be entitled to a deduction for an amount equal to the excess of the fair market value of the shares at the date such restrictions lapse over the purchase price therefor. Similarly, when deferred stock vests and is issued to the employee, the employee generally will recognize ordinary income and the Company generally will be entitled to a deduction for the amount equal to the fair market value of the shares at the date of issuance. If an election is made under Section 83(b) with respect to qualifying restricted stock, the employee generally will recognize ordinary income at the date of issuance equal to the excess, if any, of the fair market value of the shares at that date over the purchase price therefor and the Company will be entitled to a deduction for the same amount. The Code does not permit a Section 83(b) election to be made with respect to deferred stock.

*Dividend Equivalents.* A recipient of a dividend equivalent award generally will not recognize taxable income at the time of grant, and the Company will not be entitled to a deduction at that time. When a dividend equivalent is paid, the participant generally will recognize ordinary income, and the Company will be entitled to a corresponding deduction.

*Performance Awards.* A participant who has been granted a performance award generally will not recognize taxable income at the time of grant, and the Company will not be entitled to a deduction at that time. When an award is paid, whether in cash or Common Stock, the participant generally will recognize ordinary income, and the Company will be entitled to a corresponding deduction.

*Stock Payments.* A participant who receives a stock payment in lieu of a cash payment that would otherwise have been made will generally be taxed as if the cash payment has been received, and the Company generally will be entitled to a deduction for the same amount.

*Section 162(m) Limitation.* In general, under Section 162(m), income tax deductions of publicly held corporations may be limited to the extent total compensation (including base salary, annual bonus, stock option exercises, transfers of property and benefits paid under nonqualified plans) for certain executive officers exceeds \$1 million (less the amount of any excess parachute payments as defined in Section 280G of the Code) in any one year. However, under Section 162(m), the deduction limit does not apply to certain performance-based compensation. Under Section 162(m), stock options and SARs will satisfy the performance-based compensation exception if the awards of the options or SARs are made by a committee of the Board of Directors consisting solely of two or more outside directors, the plan sets the maximum number of shares that can be granted to any person within a specified period, and the compensation is based solely on an increase in the stock price after the grant date (i.e., the option or SAR exercise price is equal to or greater than the fair market value of the stock subject to the award on the grant date). Other types of awards may only qualify as performance-based compensation if such awards are granted or payable only to the recipients based upon the attainment of objectively determinable and pre-established performance targets established by a qualifying committee of the Board and related to performance goals approved by the Company's shareholders.

The 2005 Plan has been designed in order to permit the Compensation Committee to grant stock options and SARs that will qualify as performance-based compensation under Section 162(m). In addition, in order to permit Awards other than stock options and SARs to qualify as performance-based compensation, the 2005 Plan allows the Compensation Committee to designate as Section 162(m) Participants some employees whose compensation for a given fiscal year may be subject to the limit on deductible compensation imposed by Section 162(m). The Compensation Committee may grant awards to Section 162(m) Participants that vest or become exercisable upon the attainment of specific performance targets that are related to one or more of the performance goals set forth in the 2005 Plan. The Company's shareholders are also being asked in this proposal to approve the performance goals established in the 2005 Plan.

### **Performance Goals Under the 2005 Plan**

*General.* As described above, the 2005 Plan contains performance goals that govern the grant of certain awards under the 2005 Plan. The Company is requesting that the shareholders approve the performance goals for the grant of certain awards under the 2005 Plan to comply with the requirements of Section 162(m) and regulations promulgated thereunder, as discussed above.

*Eligible Employees.* Restricted stock awards, deferred stock awards, performance awards, dividend equivalents and stock payments under the 2005 Plan are limited to Section 162(m) Participants who are selected by the Compensation Committee to participate. However, only such awards granted to such Section 162(m) Participants can qualify as performance-based compensation under Section 162(m).

*Administration of Performance Goals.* The Compensation Committee has discretion to determine if awards under the 2005 Plan are intended to qualify as performance-based compensation under Section 162(m) or not. If any awards other than options or SARs are so intended to qualify, then, within 90 days of the start of each performance period, the Compensation Committee (i) designates one or more Section 162(m) Participants, (ii) selects the performance goal or goals applicable to the designated performance period, (iii) establishes the various targets and bonus amounts which may be earned for such performance period and (iv) specifies the



relationship between performance goals and targets and the amounts to be earned by each Section 162(m) Participant for such performance period. The Compensation Committee may designate, as the performance period for awards intended to be qualified performance-based compensation under the 2005 Plan, the Company's fiscal year or any other fiscal period or period of service (or such other time as may be required or permitted by Section 162(m)).

The performance goals used to determine the terms and conditions of awards intended to be qualified performance-based compensation under the 2005 Plan are based on any or all of the following business criteria with respect to the Company, any subsidiary or any division or operating unit: net earnings (either before or after interest, taxes, depreciation and amortization), economic value-added (as determined by the Compensation Committee), sales or revenue, net income (either before or after taxes), underwriting income, underwriting results, operating earnings, cash flow (including, but not limited to, operating cash flow and free cash flow), cash flow return on capital, return on net assets, return on shareholders' equity, return on assets, return on capital, shareholder returns, return on sales, gross or net profit margin, productivity, expense, margins, operating efficiency, customer satisfaction, working capital, earnings per share, price per share of the Common Stock, and market share, any of which may be measured either in absolute terms or as compared to any incremental increase or as compared to results of a peer group.

Each business criterion will be determined in accordance with generally accepted accounting principles, or will be subject to such adjustments as the Compensation Committee may specify at the beginning of the performance period with respect to an award (other than an option or SAR) that is intended to qualify as qualified performance-based compensation.

The Compensation Committee must certify the attainment of the applicable performance target before a Section 162(m) award is paid under the 2005 Plan. In determining the amounts paid to any Section 162(m) Participant, the Compensation Committee has the right to reduce (but not to increase) the amount payable at a given level of performance to take into account additional factors that it may deem relevant to the assessment of individual or corporate performance for the designated performance period.

#### **New Plan Benefits**

No awards will be granted under the 2005 Plan until it is approved by the Company's shareholders. In addition, awards granted under the 2005 Plan are subject to the discretion of the Compensation Committee. Therefore, it is not possible to determine the benefits that will be received in the future by participants in the 2005 Plan or the benefits that would have been received by such participants if the 2005 Plan had been in effect in the year ended December 31, 2004. During the year ended December 31, 2004, the Company granted options to the following persons in the aggregate amounts indicated: Named Executive Officers: 17,500; all current executive officers of the Company as a group: 42,500; all employees as a group, including executive officers of the Company: 54,500. No directors of the Company received stock option grants during 2004.

#### **Vote Required**

The affirmative vote of the majority of the shares present in person or represented by proxy and entitled to vote at the meeting is required to approve the 2005 Plan. Abstentions will be considered shares entitled to vote in the tabulation of votes cast on this proposal, and will have the same effect as negative votes. Broker non-votes are not counted for the purpose of determining whether this matter is approved, and therefore will not have the effect of a negative vote with respect to the approval of the 2005 Plan.

#### **Recommendation of the Board of Directors**

The Board of Directors unanimously recommends that shareholders vote FOR approval of the Mercury General Corporation 2005 Equity Incentive Award Plan. Proxies solicited by the Board of Directors will be so voted unless shareholders specify otherwise on the proxy cards.

#### **CERTAIN TRANSACTIONS**

Ellen Joseph, the daughter of George Joseph, is the beneficial owner of Metro West Insurance Services, Inc., a California insurance agency. In 2004, the Company paid commissions to that agency in accordance with the Company's standard agency contract of \$706,034. Louise Toney, George Joseph's sister, acts as manager for the agency and receives as compensation a portion of those commissions.

Charles E. McClung, a director of the Company, is the chairman of the board of directors of McClung Insurance Agency, Inc., which has been an independent agent of the Company since 1962. In 2004, the Company paid commissions to that agency of \$779,734.

Michael Curtius, a director of the Company, acted as a consultant to the Company during 2004. The Company paid Mr. Curtius \$185,500 for consulting services rendered to the Company in 2004.

#### **SECTION 16(a) REPORTING**

Each director, executive officer of the Company, and person who owns more than 10% of a registered class of the Company's equity securities is required by Section 16(a) of the Securities Exchange Act of 1934 to report to the Securities and Exchange Commission (the "SEC") by a specified date his or her transactions in the Company's securities. Regulations promulgated by the SEC require the Company to disclose in this Proxy Statement any reporting violations with respect to the 2004 fiscal year, which came to the Company's attention based on a review of the applicable filings required by the SEC to report such status as an officer or director or such changes in beneficial ownership as submitted to the Company. These statements are based solely on a review of the copies of such reports furnished to the Company by its officers, directors and security holders and a representation that such reports accurately reflect all reportable transactions as holdings.

#### **SHAREHOLDER PROPOSALS**

Any proposal of a shareholder of the Company intended to be presented at the next Annual Meeting of Shareholders of the Company pursuant to Rule 14a-8 of the Proxy Rules of the SEC must be received by the Secretary of the Company not later than December 2, 2005, and any proposal of a shareholder submitted outside the processes of Rule 14a-8 must be received by the Company not later than January 11, 2006 to be considered for inclusion in the Company's proxy statement and form of proxy relating to that meeting.

#### **OTHER MATTERS**

The Company does not know of any business other than that described herein which will be presented for consideration or action by the shareholders at the meeting. If, however, any other business shall properly come before the meeting, shares represented by proxies will be voted in accordance with the best judgment of the persons named therein or their substitutes.

**ANNUAL REPORTS**

**Copies of the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission are available, without charge, upon written or faxed request to: Theodore Stalick, Chief Financial Officer, Mercury General Corporation, 4484 Wilshire Boulevard, Los Angeles, California 90010 (fax: (323) 857-4923).**

The Company's Annual Report to Shareholders is being mailed with the Proxy Statement to shareholders of record on March 15, 2005. Upon request the Company will furnish the Annual Report to any shareholder.

BY ORDER OF THE BOARD OF DIRECTORS,

Judy A. Walters, *Secretary*

Los Angeles, California

April 4, 2005



**MERCURY GENERAL CORPORATION**

**2005 EQUITY INCENTIVE AWARD PLAN**

**ARTICLE 1**

**PURPOSE**

The purpose of the Mercury General Corporation 2005 Equity Incentive Award Plan (the *Plan*) is to promote the success and enhance the value of Mercury General Corporation (the *Company*) by linking the personal interests of the members of the Board and Employees to those of Company stockholders and by providing such individuals with an incentive for outstanding performance to generate superior returns to Company stockholders. The Plan is further intended to provide flexibility to the Company in its ability to motivate, attract, and retain the services of members of the Board and Employees upon whose judgment, interest, and special effort the successful conduct of the Company's operation is largely dependent.

**ARTICLE 2**

**DEFINITIONS AND CONSTRUCTION**

Wherever the following terms are used in the Plan they shall have the meanings specified below, unless the context clearly indicates otherwise. The singular pronoun shall include the plural where the context so indicates.

2.1 *Award* means an Option, a Restricted Stock award, a Stock Appreciation Right award, a Performance Share award, a Performance Stock Unit award, a Dividend Equivalents award, a Stock Payment award, a Deferred Stock award, a Restricted Stock Unit award, an Other Stock-Based Award, or a Performance-Based Award granted to a Participant pursuant to the Plan.

2.2 *Award Agreement* means any written agreement, contract, or other instrument or document evidencing an Award.

2.3 *Board* means the Board of Directors of the Company.

2.4 *Code* means the Internal Revenue Code of 1986, as amended.

2.5 *Committee* means the committee of the Board described in Article 12.

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- 2.6 *Covered Employee* means an Employee who is, or could be, a covered employee within the meaning of Section 162(m) of the Code.
- 2.7 *Deferred Stock* means a right to receive a specified number of shares of Stock during specified time periods pursuant to Article 8.
- 2.8 *Disability* means that the Participant qualifies to receive long-term disability payments under the Company's long-term disability insurance program, as it may be amended from time to time.
- 2.9 *Dividend Equivalents* means a right granted to a Participant pursuant to Article 8 to receive the equivalent value (in cash or Stock) of dividends paid on Stock.
- 2.10 *Effective Date* shall have the meaning set forth in Section 13.1.
- 2.11 *Eligible Individual* means any person who is an Employee or a member of the Board, as determined by the Committee.
- 2.12 *Employee* means any officer or other employee (as defined in accordance with Section 3401(c) of the Code) of the Company or any Subsidiary.

2.13 *Exchange Act* means the Securities Exchange Act of 1934, as amended.

2.14 *Fair Market Value* means, as of any given date, the fair market value of a share of Stock on the date determined by such methods or procedures as may be established from time to time by the Committee. Unless otherwise determined by the Committee, the Fair Market Value of a share of Stock as of any date shall be (i) the mean between the highest and lowest selling price of a share of Common Stock on the principal exchange on which shares of Common Stock are then trading, if any, on such date, or if shares were not traded on such date, then on the closest preceding date on which a trade occurred; or (ii) if Common Stock is not traded on an exchange, the mean between the closing representative bid and asked prices for the Common Stock on such date as reported by NASDAQ or, if NASDAQ is not then in existence, by its successor quotation system; or (iii) if Common Stock is not publicly traded, the Fair Market Value of a share of Common Stock as established by the Committee acting in good faith.

2.15 *Incentive Stock Option* means an Option that is intended to meet the requirements of Section 422 of the Code or any successor provision thereto.

2.16 *Independent Director* means a member of the Board who is not an Employee of the Company.

2.17 *Non-Employee Director* means a member of the Board who qualifies as a *Non-Employee Director* as defined in Rule 16b-3(b)(3) of the Exchange Act, or any successor definition adopted by the Board.

2.18 *Non-Qualified Stock Option* means an Option that is not intended to be an Incentive Stock Option.

2.19 *Option* means a right granted to a Participant pursuant to Article 5 of the Plan to purchase a specified number of shares of Stock at a specified price during specified time periods. An Option may be either an Incentive Stock Option or a Non-Qualified Stock Option.

2.20 *Other Stock-Based Award* means an Award granted or denominated in Stock or units of Stock pursuant to Section 8.7 of the Plan.

2.21 *Participant* means any Eligible Individual who, as a member of the Board or Employee, has been granted an Award pursuant to the Plan.

2.22 *Performance-Based Award* means an Award granted to selected Covered Employees pursuant to Articles 6 and 8, but which is subject to the terms and conditions set forth in Article 9. All Performance-Based Awards are intended to qualify as Qualified Performance-Based Compensation.

2.23 *Performance Criteria* means the criteria that the Committee selects for purposes of establishing the Performance Goal or Performance Goals for a Participant for a Performance Period. The Performance Criteria that will be used to establish Performance Goals are limited to the following: net earnings (either before or after interest, taxes, depreciation and amortization), economic value-added (as determined by the Committee), sales or revenue, net income (either before or after taxes), underwriting income, underwriting results, operating earnings, cash flow (including, but not limited to, operating cash flow and free cash flow), cash flow return on capital, return on net assets, return on stockholders

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equity, return on assets, return on capital, stockholder returns, return on sales, gross or net profit margin, productivity, expense, margins, operating efficiency, customer satisfaction, working capital, earnings per share, price per share of Stock, and market share, any of which may be measured either in absolute terms or as compared to any incremental increase or as compared to results of a peer group. The Committee shall, within the time prescribed by Section 162(m) of the Code, define in an objective fashion the manner of calculating the Performance Criteria it selects to use for such Performance Period for such Participant.

2.24 *Performance Goals* means, for a Performance Period, the goals established in writing by the Committee for the Performance Period based upon the Performance Criteria. Depending on the Performance

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Criteria used to establish such Performance Goals, the Performance Goals may be expressed in terms of overall Company performance or the performance of a division, business unit, or an individual. The Committee, in its discretion, may, within the time prescribed by Section 162(m) of the Code, adjust or modify the calculation of Performance Goals for such Performance Period in order to prevent the dilution or enlargement of the rights of Participants (a) in the event of, or in anticipation of, any unusual or extraordinary corporate item, transaction, event, or development, or (b) in recognition of, or in anticipation of, any other unusual or nonrecurring events affecting the Company, or the financial statements of the Company, or in response to, or in anticipation of, changes in applicable laws, regulations, accounting principles, or business conditions.

2.25 *Performance Period* means the one or more periods of time, which may be of varying and overlapping durations, as the Committee may select, over which the attainment of one or more Performance Goals will be measured for the purpose of determining a Participant's right to, and the payment of, a Performance-Based Award.

2.26 *Performance Share* means a right granted to a Participant pursuant to Article 8, to receive Stock, the payment of which is contingent upon achieving certain Performance Goals or other performance-based targets established by the Committee.

2.27 *Performance Stock Unit* means a right granted to a Participant pursuant to Article 8, to receive Stock, the payment of which is contingent upon achieving certain Performance Goals or other performance-based targets established by the Committee.

2.28 *Plan* means this Mercury General Corporation 2005 Equity Incentive Award Plan, as it may be amended from time to time.

2.29 *Qualified Performance-Based Compensation* means any compensation that is intended to qualify as qualified performance-based compensation as described in Section 162(m)(4)(C) of the Code.

2.30 *Restricted Stock* means Stock awarded to a Participant pursuant to Article 6 that is subject to certain restrictions and may be subject to risk of forfeiture.

2.31 *Restricted Stock Unit* means an Award granted pursuant to Section 8.6.

2.32 *Securities Act* shall mean the Securities Act of 1933, as amended.

2.33 *Stock* means the common stock of the Company, without par value, and such other securities of the Company that may be substituted for Stock pursuant to Article 11.

2.34 *Stock Appreciation Right* or *SAR* means a right granted pursuant to Article 7 to receive a payment equal to the excess of the Fair Market Value of a specified number of shares of Stock on the date the SAR is exercised over the Fair Market Value on the date the SAR was granted as set forth in the applicable Award Agreement.

2.35 *Stock Payment* means (a) a payment in the form of shares of Stock, or (b) an option or other right to purchase shares of Stock, as part of any bonus, deferred compensation or other arrangement, made in lieu of all or any portion of the compensation, granted pursuant to Article 8.

2.36 *Subsidiary* means any subsidiary corporation as defined in Section 424(f) of the Code and any applicable regulations promulgated thereunder or any other entity of which a majority of the outstanding voting stock or voting power is beneficially owned directly or indirectly by the Company.

**ARTICLE 3**

**SHARES SUBJECT TO THE PLAN**

3.1 *Number of Shares.*

(a) Subject to Article 11 and Section 3.1(b), the aggregate number of shares of Stock which may be issued or transferred pursuant to Awards under the Plan shall be 5,400,000 shares. In order that the applicable regulations under the Code relating to Incentive Stock Options be satisfied, the maximum number of shares of Stock that may be delivered upon exercise of Incentive Stock Options shall be the number specified in this Section 3.1(a), and, if necessary to satisfy such regulations, such maximum limit shall apply to the number of shares of Stock that may be delivered in connection with each other type of Award under the Plan (applicable separately to each type of Award).

(b) To the extent that an Award terminates, expires, or lapses for any reason, any shares of Stock subject to the Award shall again be available for the grant of an Award pursuant to the Plan. Additionally, any shares of Stock tendered or withheld to satisfy the grant or exercise price or tax withholding obligation pursuant to any Award shall again be available for the grant of an Award pursuant to the Plan. To the extent permitted by applicable law or any exchange rule, shares of Stock issued in assumption of, or in substitution for, any outstanding awards of any entity acquired in any form of combination by the Company or any Subsidiary shall not be counted against shares of Stock available for grant pursuant to this Plan. The payment of Dividend Equivalents in conjunction with any outstanding Awards shall not be counted against the shares available for issuance under the Plan.

3.2 *Stock Distributed.* Any Stock distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Stock, treasury Stock or Stock purchased on the open market.

3.3 *Limitation on Number of Shares Subject to Awards.* Notwithstanding any provision in the Plan to the contrary, and subject to Article 11, the maximum number of shares of Stock with respect to one or more Awards that may be granted to any one Participant during a one-year period (measured from the date of any grant) shall be 100,000.

**ARTICLE 4**

**ELIGIBILITY AND PARTICIPATION**

4.1 *Eligibility.* Each Eligible Individual shall be eligible to be granted one or more Awards pursuant to the Plan.

4.2 *Participation.* Subject to the provisions of the Plan, the Committee may, from time to time, select from among all Eligible Individuals, those to whom Awards shall be granted and shall determine the nature and amount of each Award. No Eligible Individual shall have any right to be granted an Award pursuant to this Plan.

4.3 *Foreign Participants.* In order to assure the viability of Awards granted to Participants employed in foreign countries, the Committee may provide for such special terms as it may consider necessary or appropriate to accommodate differences in local law, tax policy, or custom. Moreover, the Committee may approve such supplements to, or amendments, restatements, or alternative versions of, the Plan as it may consider necessary or appropriate for such purposes without thereby affecting the terms of the Plan as in effect for any other purpose; *provided, however*, that no such supplements, amendments, restatements, or alternative versions shall increase the share limitations contained in Sections 3.1 and 3.3 of the Plan.

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ARTICLE 5

STOCK OPTIONS

5.1 *General.* The Committee is authorized to grant Options to Participants on the following terms and conditions:

(a) *Exercise Price.* The exercise price per share of Stock subject to an Option shall be determined by the Committee and set forth in the Award Agreement; *provided* that the exercise price for any Option shall not be less than 100% of the Fair Market Value of a share of Stock on the date of the grant.

(b) *Time and Conditions of Exercise.* The Committee shall determine the time or times at which an Option may be exercised in whole or in part; *provided* that the term of any Option granted under the Plan shall not exceed ten years. The Committee shall also determine the performance or other conditions, if any, that must be satisfied before all or part of an Option may be exercised.

(c) *Payment.* The Committee shall determine the methods by which the exercise price of an Option may be paid, the form of payment, including, without limitation: (i) cash, (ii) promissory note bearing interest at no less than such rate as shall preclude the imputation of interest under the Code, (iii) shares of Stock held for such period of time as may be required by the Committee in order to avoid adverse accounting consequences and having a Fair Market Value on the date of delivery equal to the aggregate exercise price of the Option or exercised portion thereof, or (iv) other property acceptable to the Committee (including through the delivery of a notice that the Participant has placed a market sell order with a broker with respect to shares of Stock then issuable upon exercise of the Option, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to the Company in satisfaction of the Option exercise price; *provided* that payment of such proceeds is then made to the Company upon settlement of such sale), and the methods by which shares of Stock shall be delivered or deemed to be delivered to Participants. Notwithstanding any other provision of the Plan to the contrary, no Participant who is a member of the Board or an executive officer of the Company within the meaning of Section 13(k) of the Exchange Act shall be permitted to pay the exercise price of an Option in any method which would violate Section 13(k) of the Exchange Act.

(d) *Evidence of Grant.* All Options shall be evidenced by a written Award Agreement between the Company and the Participant. The Award Agreement shall include such additional provisions as may be specified by the Committee.

5.2 *Incentive Stock Options.* The terms of any Incentive Stock Options granted pursuant to the Plan must comply with the conditions and limitations contained Section 13.2 and this Section 5.2.

(a) *Eligibility.* Incentive Stock Options may be granted only to employees of the Company or any subsidiary corporation thereof (within the meaning of Section 424(f) of the Code and the applicable regulations promulgated thereunder).

(b) *Exercise Price.* The exercise price per share of Stock shall be set by the Committee; *provided* that subject to Section 5.2(e) the exercise price for any Incentive Stock Option shall not be less than 100% of the Fair Market Value on the date of grant.

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(c) *Expiration.* Subject to Section 5.2(e), an Incentive Stock Option may not be exercised to any extent by anyone after the tenth anniversary of the date it is granted, or such earlier time set forth in the Award Agreement.

(d) *Individual Dollar Limitation.* The aggregate Fair Market Value (determined as of the time the Option is granted) of all shares of Stock with respect to which Incentive Stock Options are first exercisable by a Participant in any calendar year may not exceed \$100,000 or such other limitation as imposed by Section 422(d) of the Code, or any successor provision. To the extent that Incentive Stock Options are first exercisable by a Participant in excess of such limitation, the excess shall be considered Non-Qualified Stock Options.

(e) *Ten Percent Owners.* An Incentive Stock Option shall be granted to any individual who, at the date of grant, owns stock possessing more than ten percent of the total combined voting power of all classes of Stock of the Company only if such Option is granted at a price that is not less than 110% of Fair Market Value on the date of grant and the Option is exercisable for no more than five years from the date of grant.

(f) *Notice of Disposition.* The Participant shall give the Company prompt notice of any disposition of shares of Stock acquired by exercise of an Incentive Stock Option within (i) two years from the date of grant of such Incentive Stock Option or (ii) one year after the transfer of such shares of Stock to the Participant.

(g) *Right to Exercise.* During a Participant's lifetime, an Incentive Stock Option may be exercised only by the Participant.

5.3 *Substitution of Stock Appreciation Rights.* The Committee may provide in the Award Agreement evidencing the grant of an Option that the Committee, in its sole discretion, shall have to right to substitute a Stock Appreciation Right for such Option at any time prior to or upon exercise of such Option, subject to the provisions of Section 7.2 hereof; provided that such Stock Appreciation Right shall be exercisable with respect to the same number of shares of Stock for which such substituted Option would have been exercisable.

5.4 *Paperless Exercise.* In the event that the Company establishes, for itself or using the services of a third party, an automated system for the exercise of Options, such as a system using an internet website or interactive voice response, then the paperless exercise of options by a Participant may be permitted through the use of such an automated system.

5.5 *Granting of Options to Independent Directors.* The Board may from time to time, in its sole discretion, and subject to the limitations of the Plan:

(a) Select from among the Independent Directors (including Independent Directors who have previously been granted Options under the Plan) such of them as in its opinion should be granted Options;

(b) Subject to Section 3.3, determine the number of shares of Stock that may be purchased upon exercise of the Options granted to such selected Independent Directors; and

(c) Subject to the provisions of this Article 5, determine the terms and conditions of such Options, consistent with the Plan.

Options granted to Independent Directors shall be Non-Qualified Stock Options.

## ARTICLE 6

### RESTRICTED STOCK AWARDS

6.1 *Grant of Restricted Stock.* The Committee is authorized to make Awards of Restricted Stock to any Participant selected by the Committee in such amounts and subject to such terms and conditions as determined by the Committee. All Awards of Restricted Stock shall be evidenced by a written Restricted Stock Award Agreement.

6.2 *Issuance and Restrictions.* Restricted Stock shall be subject to such restrictions on transferability and other restrictions as the Committee may impose (including, without limitation, limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock). These restrictions may lapse separately or in combination at such times, pursuant to such circumstances, in such installments, or otherwise, as the Committee determines at the time of the grant of the Award or thereafter.

6.3 *Forfeiture.* Except as otherwise determined by the Committee at the time of the grant of the Award or thereafter, upon termination of employment or service during the applicable restriction period, Restricted Stock that is at that time subject to restrictions shall be forfeited; *provided, however,* that the Committee may (a) provide in any Restricted Stock Award Agreement that restrictions or forfeiture conditions relating to

Restricted Stock will be waived in whole or in part in the event of terminations resulting from specified causes, and (b) in other cases waive in whole or in part restrictions or forfeiture conditions relating to Restricted Stock.

6.4 *Certificates for Restricted Stock.* Restricted Stock granted pursuant to the Plan may be evidenced in such manner as the Committee shall determine. If certificates representing shares of Restricted Stock are registered in the name of the Participant, certificates must bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock, and the Company may, at its discretion, retain physical possession of the certificate until such time as all applicable restrictions lapse.

## ARTICLE 7

### STOCK APPRECIATION RIGHTS

7.1 *Grant of Stock Appreciation Rights.* A Stock Appreciation Right may be granted to any Participant selected by the Committee. A Stock Appreciation Right may be granted (a) in connection and simultaneously with the grant of an Option, (b) with respect to a previously granted Option, or (c) independent of an Option. A Stock Appreciation Right shall be subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose and shall be evidenced by an Award Agreement.

7.2 *Coupled Stock Appreciation Rights.*

(a) A Coupled Stock Appreciation Right ( *CSAR* ) shall be related to a particular Option and shall be exercisable only when and to the extent the related Option is exercisable, *provided, however*, that the exercise price for any CSAR shall not be less than 100% of the Fair Market Value on the date of grant; and *provided, further*, that, the Committee in its sole and absolute discretion may provide that the CSAR may be exercised subsequent to a termination of employment or service, as applicable, or because of the Participant's retirement, death or disability, or otherwise.

(b) A CSAR may be granted to a Participant for no more than the number of shares subject to the simultaneously or previously granted Option to which it is coupled.

(c) A CSAR shall entitle the Participant (or other person entitled to exercise the Option pursuant to the Plan) to surrender to the Company the unexercised portion of the Option to which the CSAR relates (to the extent then exercisable pursuant to its terms) and to receive from the Company in exchange therefor an amount determined by multiplying the difference obtained by subtracting the Option exercise price from the Fair Market Value of a share of Stock on the date of exercise of the CSAR by the number of shares of Stock with respect to which the CSAR shall have been exercised, subject to any limitations the Committee may impose.

7.3 *Independent Stock Appreciation Rights.*

(a) An Independent Stock Appreciation Right ( *ISAR* ) shall be unrelated to any Option and shall have a term set by the Committee. An ISAR shall be exercisable in such installments as the Committee may determine. An ISAR shall cover such number of shares of Stock as the

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Committee may determine. The exercise price per share of Stock subject to each ISAR shall be set by the Committee; *provided, however*, that the exercise price for any ISAR shall not be less than 100% of the Fair Market Value on the date of grant; and *provided, further*, that, the Committee in its sole and absolute discretion may provide that the ISAR may be exercised subsequent to a termination of employment or service, as applicable, or because of the Participant's retirement, death or disability, or otherwise.

(b) An ISAR shall entitle the Participant (or other person entitled to exercise the ISAR pursuant to the Plan) to exercise all or a specified portion of the ISAR (to the extent then exercisable pursuant to its terms) and to receive from the Company an amount determined by multiplying the difference obtained by subtracting the exercise price per share of the ISAR from the Fair Market Value of a share of Stock on the date of exercise of the ISAR by the number of shares of Stock with respect to which the ISAR shall have been exercised, subject to any limitations the Committee may impose.

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7.4 *Payment and Limitations on Exercise.*

(a) Payment of the amounts determined under Sections 7.2(c) and 7.3(b) above shall be in cash, in Stock (based on its Fair Market Value as of the date the Stock Appreciation Right is exercised) or a combination of both, as determined by the Committee.

(b) To the extent any payment under Section 7.2(c) or 7.3(b) is effected in Stock it shall be made subject to satisfaction of all provisions of Article 5 above pertaining to Options.

**ARTICLE 8**

**OTHER TYPES OF AWARDS**

8.1 *Performance Share Awards.* Any Participant selected by the Committee may be granted one or more Performance Share awards which shall be denominated in a number of shares of Stock and which may be linked to any one or more of the Performance Criteria or other specific performance criteria determined appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. In making such determinations, the Committee shall consider (among such other factors as it deems relevant in light of the specific type of award) the contributions, responsibilities and other compensation of the particular Participant.

8.2 *Performance Stock Units.* Any Participant selected by the Committee may be granted one or more Performance Stock Unit awards which shall be denominated in units of value including dollar value of shares of Stock and which may be linked to any one or more of the Performance Criteria or other specific performance criteria determined appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. In making such determinations, the Committee shall consider (among such other factors as it deems relevant in light of the specific type of award) the contributions, responsibilities and other compensation of the particular Participant.

8.3 *Dividend Equivalents.*

(a) Any Participant selected by the Committee may be granted Dividend Equivalents based on the dividends declared on the shares of Stock that are subject to any Award, to be credited as of dividend payment dates, during the period between the date the Award is granted and the date the Award is exercised, vests or expires, as determined by the Committee. Such Dividend Equivalents shall be converted to cash or additional shares of Stock by such formula and at such time and subject to such limitations as may be determined by the Committee.

(b) Dividend Equivalents granted with respect to Options or SARs that are intended to be Qualified Performance-Based Compensation shall be payable, with respect to pre-exercise periods, regardless of whether such Option or SAR is subsequently exercised.

8.4 *Stock Payments.* Any Participant selected by the Committee may receive Stock Payments in the manner determined from time to time by the Committee. The number of shares shall be determined by the Committee and may be based upon the Performance Criteria or other specific performance criteria determined appropriate by the Committee, determined on the date such Stock Payment is made or on any date thereafter.

8.5 *Deferred Stock.* Any Participant selected by the Committee may be granted an award of Deferred Stock in the manner determined from time to time by the Committee. The number of shares of Deferred Stock shall be determined by the Committee and may be linked to the Performance Criteria or other specific performance criteria determined to be appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. Stock underlying a Deferred Stock award will not be issued until the Deferred Stock award has vested, pursuant to a vesting schedule or performance criteria set by

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the Committee. Unless otherwise provided by the Committee, a Participant awarded Deferred Stock shall have no rights as a Company stockholder with respect to such Deferred Stock until such time as the Deferred Stock Award has vested and the Stock underlying the Deferred Stock Award has been issued.

8.6 *Restricted Stock Units.* The Committee is authorized to make Awards of Restricted Stock Units to any Participant selected by the Committee in such amounts and subject to such terms and conditions as determined by the Committee. At the time of grant, the Committee shall specify the date or dates on which the Restricted Stock Units shall become fully vested and nonforfeitable, and may specify such conditions to vesting as it deems appropriate. At the time of grant, the Committee shall specify the maturity date applicable to each grant of Restricted Stock Units which shall be no earlier than the vesting date or dates of the Award and may be determined at the election of the grantee. On the maturity date, the Company shall, subject to Section 10.5(b), transfer to the Participant one unrestricted, fully transferable share of Stock for each Restricted Stock Unit scheduled to be paid out on such date and not previously forfeited. The Committee shall specify the purchase price, if any, to be paid by the grantee to the Company for such shares of Stock.

8.7 *Other Stock-Based Awards.* Any Participant selected by the Committee may be granted one or more Awards that provide Participants with shares of Stock or the right to purchase shares of Stock or that have a value derived from the value of, or an exercise or conversion privilege at a price related to, or that are otherwise payable in shares of Stock and which may be linked to any one or more of the Performance Criteria or other specific performance criteria determined appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. In making such determinations, the Committee shall consider (among such other factors as it deems relevant in light of the specific type of Award) the contributions, responsibilities and other compensation of the particular Participant.

8.8 *Term.* Except as otherwise provided herein, the term of any Award of Performance Shares, Performance Stock Units, Dividend Equivalents, Stock Payments, Deferred Stock, Restricted Stock Units or Other Stock-Based Award shall be set by the Committee in its discretion.

8.9 *Exercise or Purchase Price.* The Committee may establish the exercise or purchase price, if any, of any Award of Performance Shares, Performance Stock Units, Deferred Stock, Stock Payments, Restricted Stock Units or Other Stock-Based Award; *provided, however*, that such price shall not be less than the par value of a share of Stock on the date of grant, unless otherwise permitted by applicable state law.

8.10 *Exercise Upon Termination of Employment or Service.* An Award of Performance Shares, Performance Stock Units, Dividend Equivalents, Deferred Stock, Stock Payments, Restricted Stock Units and Other Stock-Based Award shall only be exercisable or payable while the Participant is an Employee or a member of the Board, as applicable; *provided, however*, that the Committee in its sole and absolute discretion may provide that an Award of Performance Shares, Performance Stock Units, Dividend Equivalents, Stock Payments, Deferred Stock, Restricted Stock Units or Other Stock-Based Award may be exercised or paid subsequent to a termination of employment or service, as applicable, or because of the Participant's retirement, death or disability, or otherwise; *provided, however*, that any such provision with respect to Performance Shares or Performance Stock Units shall be subject to the requirements of Section 162(m) of the Code that apply to Qualified Performance-Based Compensation.

8.11 *Form of Payment.* Payments with respect to any Awards granted under this Article 8 shall be made in cash, in Stock or a combination of both, as determined by the Committee.

8.12 *Award Agreement.* All Awards under this Article 8 shall be subject to such additional terms and conditions as determined by the Committee and shall be evidenced by a written Award Agreement.



**ARTICLE 9**

**PERFORMANCE-BASED AWARDS**

9.1 *Purpose.* The purpose of this Article 9 is to provide the Committee the ability to qualify Awards other than Options and SARs and that are granted pursuant to Articles 6 and 8 as Qualified Performance-Based Compensation. If the Committee, in its discretion, decides to grant a Performance-Based Award to a Covered Employee, the provisions of this Article 9 shall control over any contrary provision contained in Articles 6 or 8; *provided, however*, that the Committee may in its discretion grant Awards to Covered Employees that are based on Performance Criteria or Performance Goals but that do not satisfy the requirements of this Article 9.

9.2 *Applicability.* This Article 9 shall apply only to those Covered Employees selected by the Committee to receive Performance-Based Awards. The designation of a Covered Employee as a Participant for a Performance Period shall not in any manner entitle the Participant to receive an Award for the period. Moreover, designation of a Covered Employee as a Participant for a particular Performance Period shall not require designation of such Covered Employee as a Participant in any subsequent Performance Period and designation of one Covered Employee as a Participant shall not require designation of any other Covered Employees as a Participant in such period or in any other period.

9.3 *Procedures with Respect to Performance-Based Awards.* To the extent necessary to comply with the Qualified Performance-Based Compensation requirements of Section 162(m)(4)(C) of the Code, with respect to any Award granted under Articles 6 and 8 which may be granted to one or more Covered Employees, no later than ninety (90) days following the commencement of any fiscal year in question or any other designated fiscal period or period of service (or such other time as may be required or permitted by Section 162(m) of the Code), the Committee shall, in writing, (a) designate one or more Covered Employees, (b) select the Performance Criteria applicable to the Performance Period, (c) establish the Performance Goals, and amounts of such Awards, as applicable, which may be earned for such Performance Period, and (d) specify the relationship between Performance Criteria and the Performance Goals and the amounts of such Awards, as applicable, to be earned by each Covered Employee for such Performance Period. Following the completion of each Performance Period, the Committee shall certify in writing whether the applicable Performance Goals have been achieved for such Performance Period. In determining the amount earned by a Covered Employee, the Committee shall have the right to reduce or eliminate (but not to increase) the amount payable at a given level of performance to take into account additional factors that the Committee may deem relevant to the assessment of individual or corporate performance for the Performance Period.

9.4 *Payment of Performance-Based Awards.* Unless otherwise provided in the applicable Award Agreement, a Participant must be employed by the Company or a Subsidiary on the day a Performance-Based Award for such Performance Period is paid to the Participant. Furthermore, a Participant shall be eligible to receive payment pursuant to a Performance-Based Award for a Performance Period only if the Performance Goals for such period are achieved.

9.5 *Additional Limitations.* Notwithstanding any other provision of the Plan, any Award which is granted to a Covered Employee and is intended to constitute Qualified Performance-Based Compensation shall be subject to any additional limitations set forth in Section 162(m) of the Code (including any amendment to Section 162(m) of the Code) or any regulations or rulings issued thereunder that are requirements for qualification as qualified performance-based compensation as described in Section 162(m)(4)(C) of the Code, and the Plan shall be deemed amended to the extent necessary to conform to such requirements.

**ARTICLE 10**

**PROVISIONS APPLICABLE TO AWARDS**

10.1 *Stand-Alone and Tandem Awards.* Awards granted pursuant to the Plan may, in the discretion of the Committee, be granted either alone, in addition to, or in tandem with, any other Award granted pursuant to the Plan. Awards granted in addition to or in tandem with other Awards may be granted either at the same time as or at a different time from the grant of such other Awards.

10.2 *Award Agreement.* Awards under the Plan shall be evidenced by Award Agreements that set forth the terms, conditions and limitations for each Award which may include the term of an Award, the provisions applicable in the event the Participant's employment or service terminates, and the Company's authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind an Award.

10.3 *Limits on Transfer.* No right or interest of a Participant in any Award may be pledged, encumbered, or hypothecated to or in favor of any party other than the Company or a Subsidiary, or shall be subject to any lien, obligation, or liability of such Participant to any other party other than the Company or a Subsidiary. Except as otherwise provided by the Committee, no Award shall be assigned, transferred, or otherwise disposed of by a Participant other than by will or the laws of descent and distribution. The Committee by express provision in the Award or an amendment thereto may permit an Award (other than an Incentive Stock Option) to be transferred to, exercised by and paid to certain persons or entities related to the Participant, including but not limited to members of the Participant's family, charitable institutions, or trusts or other entities whose beneficiaries or beneficial owners are members of the Participant's family and/or charitable institutions, or to such other persons or entities as may be expressly approved by the Committee, pursuant to such conditions and procedures as the Committee may establish. Any permitted transfer shall be subject to the condition that the Committee receive evidence satisfactory to it that the transfer is being made for estate and/or tax planning purposes (or to a blind trust in connection with the Participant's termination of employment or service with the Company or a Subsidiary to assume a position with a governmental, charitable, educational or similar non-profit institution) and on a basis consistent with the Company's lawful issue of securities.

10.4 *Beneficiaries.* Notwithstanding Section 10.3, a Participant may, in the manner determined by the Committee, designate a beneficiary to exercise the rights of the Participant and to receive any distribution with respect to any Award upon the Participant's death. A beneficiary, legal guardian, legal representative, or other person claiming any rights pursuant to the Plan is subject to all terms and conditions of the Plan and any Award Agreement applicable to the Participant, except to the extent the Plan and Award Agreement otherwise provide, and to any additional restrictions deemed necessary or appropriate by the Committee. If the Participant is married and resides in a community property state, a designation of a person other than the Participant's spouse as his or her beneficiary with respect to more than 50% of the Participant's interest in the Award shall not be effective without the prior written consent of the Participant's spouse. If no beneficiary has been designated or survives the Participant, payment shall be made to the person entitled thereto pursuant to the Participant's will or the laws of descent and distribution. Subject to the foregoing, a beneficiary designation may be changed or revoked by a Participant at any time provided the change or revocation is filed with the Committee.

10.5 *Stock Certificates; Book Entry Procedures.*

(a) Notwithstanding anything herein to the contrary, the Company shall not be required to issue or deliver any certificates evidencing shares of Stock pursuant to the exercise of any Award, unless and until the Board has determined, with advice of counsel, that the issuance and delivery of such certificates is in compliance with all applicable laws, regulations of governmental authorities and, if applicable, the requirements of any exchange on which the shares of Stock are listed or traded. All Stock certificates delivered pursuant to the Plan are subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal, state, or foreign jurisdiction, securities or other laws, rules and regulations and the rules of any national securities exchange or automated quotation system on

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which the Stock is listed, quoted, or traded. The Committee may place legends on any Stock certificate to reference restrictions applicable to the Stock. In addition to the terms and conditions provided herein, the Board may require that a Participant make such reasonable covenants, agreements, and representations as the Board, in its discretion, deems advisable in order to comply with any such laws, regulations, or requirements. The Committee shall have the right to require any Participant to comply with any timing or other restrictions with respect to the settlement or exercise of any Award, including a window-period limitation, as may be imposed in the discretion of the Committee.

(b) Notwithstanding any other provision of the Plan, unless otherwise determined by the Committee or required by any applicable law, rule or regulation, the Company shall not deliver to any Participant certificates evidencing shares of Stock issued in connection with any Award and instead such shares of Stock shall be recorded in the books of the Company (or, as applicable, its transfer agent or stock plan administrator).

## ARTICLE 11

### CHANGES IN CAPITAL STRUCTURE

#### 11.1 *Adjustments.*

(a) In the event of any stock dividend, stock split, combination or exchange of shares, merger, consolidation, spin-off, recapitalization, distribution of Company assets to stockholders (other than normal cash dividends), or any other corporate event affecting the Stock or the share price of the Stock, the Committee may make such proportionate adjustments, if any, as the Committee in its discretion may deem appropriate to reflect such changes with respect to (i) the aggregate number and type of shares that may be issued under the Plan (including, but not limited to, adjustments of the limitations in Sections 3.1 and 3.3); (ii) the terms and conditions of any outstanding Awards (including, without limitation, any applicable performance targets or criteria with respect thereto); and (iii) the grant or exercise price per share for any outstanding Awards under the Plan. Any adjustment affecting an Award intended as Qualified Performance-Based Compensation shall be made consistent with the requirements of Section 162(m) of the Code.

(b) In the event of any transaction or event described in Section 11.1(a) or any unusual or nonrecurring transactions or events affecting the Company, any affiliate of the Company, or the financial statements of the Company or any affiliate, or of changes in applicable laws, regulations or accounting principles, and whenever the Committee determines that action is appropriate in order to prevent the dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan or with respect to any Award under the Plan, to facilitate such transactions or events or to give effect to such changes in laws, regulations or principles, the Committee, in its sole discretion and on such terms and conditions as it deems appropriate, either by amendment of the terms of any outstanding Awards or by action taken prior to the occurrence of such transaction or event and either automatically or upon the Participant's request, is hereby authorized to take any one or more of the following actions:

(i) To provide for either (A) termination of any such Award in exchange for an amount of cash and/or other property, if any, equal to the amount that would have been attained upon the exercise of such Award or realization of the Participant's rights (and, for the avoidance of doubt, if as of the date of the occurrence of the transaction or event described in this Section 11.1(b) the Committee determines in good faith that no amount would have been attained upon the exercise of such Award or realization of the Participant's rights, then such Award may be terminated by the Company without payment) or (B) the replacement of such Award with other rights or property selected by the Committee in its sole discretion;

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(ii) To provide that such Award be assumed by the successor or survivor corporation, or a parent or subsidiary thereof, or shall be substituted for by similar options, rights or awards covering the stock of the successor or survivor corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number and kind of shares and prices; and

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(iii) To make adjustments in the number and type of shares of Stock (or other securities or property) subject to outstanding Awards, and in the number and kind of outstanding Restricted Stock or Deferred Stock and/or in the terms and conditions of (including the grant or exercise price), and the criteria included in, outstanding options, rights and awards and options, rights and awards which may be granted in the future;

(iv) To provide that such Award shall be exercisable or payable or fully vested with respect to all shares covered thereby, notwithstanding anything to the contrary in the Plan or the applicable Award Agreement; and

(v) To provide that the Award cannot vest, be exercised or become payable after such event.

11.2 *Outstanding Awards Other Changes.* In the event of any other change in the capitalization of the Company or corporate change other than those specifically referred to in this Article 11, the Committee may, in its absolute discretion, make such adjustments in the number and kind of shares or other securities subject to Awards outstanding on the date on which such change occurs and in the per share grant or exercise price of each Award as the Committee may consider appropriate to prevent dilution or enlargement of rights.

11.3 *No Other Rights.* Except as expressly provided in the Plan, no Participant shall have any rights by reason of any subdivision or consolidation of shares of stock of any class, the payment of any dividend, any increase or decrease in the number of shares of stock of any class or any dissolution, liquidation, merger, or consolidation of the Company or any other corporation. Except as expressly provided in the Plan or pursuant to action of the Committee under the Plan, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number of shares of Stock subject to an Award or the grant or exercise price of any Award.

## ARTICLE 12

### ADMINISTRATION

12.1 *Committee.* Unless and until the Board delegates administration of the Plan to a Committee as set forth below, the Plan shall be administered by the full Board, and for such purposes the term Committee as used in this Plan shall be deemed to refer to the Board. The Board, at its discretion or as otherwise necessary to comply with the requirements of Section 162(m) of the Code, Rule 16b-3 promulgated under the Exchange Act or to the extent required by any other applicable rule or regulation, shall delegate administration of the Plan to a Committee. The Committee shall consist solely of two or more members of the Board each of whom is both an outside director, within the meaning of Section 162(m) of the Code and any other applicable rules and regulations, and a Non-Employee Director. Notwithstanding the foregoing: (a) the full Board, acting by a majority of its members in office, shall conduct the general administration of the Plan with respect to all Awards granted to Independent Directors and for purposes of such Awards the term Committee as used in this Plan shall be deemed to refer to the Board and (b) the Committee may delegate its authority hereunder to the extent permitted by Section 12.5. Appointment of Committee members shall be effective upon acceptance of appointment. The Board may abolish the Committee at any time and revert in the Board the administration of the Plan. Committee members may resign at any time by delivering written notice to the Board. Vacancies in the Committee may only be filled by the Board.

12.2 *Action by the Committee.* A majority of the Committee shall constitute a quorum. The acts of a majority of the members present at any meeting at which a quorum is present, and acts approved in writing by a majority of the Committee in lieu of a meeting, shall be deemed the acts of the Committee. Each member of the Committee is entitled to, in good faith, rely or act upon any report or other information furnished to that member by any officer or other employee of the Company or any Subsidiary, the Company's independent certified public accountants, or any



executive compensation consultant or other professional retained by the Company to assist in the administration of the Plan.

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12.3 *Authority of Committee.* Subject to any specific designation in the Plan, the Committee has the exclusive power, authority and discretion to:

- (a) Designate Participants to receive Awards;
- (b) Determine the type or types of Awards to be granted to each Participant;
- (c) Determine the number of Awards to be granted and the number of shares of Stock to which an Award will relate;
- (d) Determine the terms and conditions of any Award granted pursuant to the Plan, including, but not limited to, the exercise price, grant price, or purchase price, any reload provision, any restrictions or limitations on the Award, any schedule for lapse of forfeiture restrictions or restrictions on the exercisability of an Award, and accelerations or waivers thereof, any provisions related to non-competition and recapture of gain on an Award, based in each case on such considerations as the Committee in its sole discretion determines; *provided, however*, that the Committee shall not have the authority to accelerate the vesting or waive the forfeiture of any Performance-Based Awards;
- (e) Determine whether, to what extent, and pursuant to what circumstances an Award may be settled in, or the exercise price of an Award may be paid in, cash, Stock, other Awards, or other property, or an Award may be canceled, forfeited, or surrendered;
- (f) Prescribe the form of each Award Agreement, which need not be identical for each Participant;
- (g) Decide all other matters that must be determined in connection with an Award;
- (h) Establish, adopt, or revise any rules and regulations as it may deem necessary or advisable to administer the Plan;
- (i) Interpret the terms of, and any matter arising pursuant to, the Plan or any Award Agreement; and
- (j) Make all other decisions and determinations that may be required pursuant to the Plan or as the Committee deems necessary or advisable to administer the Plan.

12.4 *Decisions Binding.* The Committee's interpretation of the Plan, any Awards granted pursuant to the Plan, any Award Agreement and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties.

12.5 *Delegation of Authority.* To the extent permitted by applicable law, the Committee may from time to time delegate to a committee of one or more members of the Board or one or more officers of the Company the authority to grant or amend Awards to Participants other than (a) senior executives of the Company who are subject to Section 16 of the Exchange Act, (b) Covered Employees, or (c) officers of the Company (or members of the Board) to whom authority to grant or amend Awards has been delegated hereunder. Any delegation hereunder shall be subject to the restrictions and limits that the Committee specifies at the time of such delegation, and the Committee may at any time rescind the authority so delegated or appoint a new delegatee. At all times, the delegatee appointed under this Section 12.5 shall serve in such capacity at the pleasure of the Committee.

### ARTICLE 13

#### EFFECTIVE AND EXPIRATION DATE

13.1 *Effective Date.* The Plan is effective as of the date the Plan is approved by the Company's stockholders (the *Effective Date*). The Plan will be deemed to be approved by the stockholders if it receives the affirmative vote of the holders of a majority of the shares of stock of the Company present or represented and entitled to vote at a meeting duly held in accordance with the applicable provisions of the Company's Bylaws.

13.2 *Expiration Date.* The Plan will expire on, and no Incentive Stock Option or other Award may be granted pursuant to the Plan after, the earlier of the tenth anniversary of (i) the Effective Date or (ii) the date this Plan is approved by the Board. Any Awards that are outstanding on the tenth anniversary of the Effective Date shall remain in force according to the terms of the Plan and the applicable Award Agreement.

## ARTICLE 14

### AMENDMENT, MODIFICATION, AND TERMINATION

14.1 *Amendment, Modification, And Termination.* With the approval of the Board, at any time and from time to time, the Committee may terminate, amend or modify the Plan; *provided, however,* that (a) to the extent necessary and desirable to comply with any applicable law, regulation, or stock exchange rule, the Company shall obtain stockholder approval of any Plan amendment in such a manner and to such a degree as required, and (b) stockholder approval is required for any amendment to the Plan that (i) increases the number of shares available under the Plan (other than any adjustment as provided by Article 11), (ii) permits the Committee to grant Options with an exercise price that is below Fair Market Value on the date of grant, (iii) permits the Committee to extend the exercise period for an Option beyond ten years from the date of grant or (iv) results in a material increase in benefits or a change in eligibility requirements. Notwithstanding any provision in this Plan to the contrary, absent approval of the stockholders of the Company, no Option may be amended to reduce the per share exercise price of the shares subject to such Option below the per share exercise price as of the date the Option is granted and, except as permitted by Article 11, no Option may be granted in exchange for, or in connection with, the cancellation or surrender of an Option having a higher per share exercise price.

14.2 *Awards Previously Granted.* No termination, amendment, or modification of the Plan shall adversely affect in any material way any Award previously granted pursuant to the Plan without the prior written consent of the Participant.

## ARTICLE 15

### GENERAL PROVISIONS

15.1 *No Rights to Awards.* No Eligible Individual or other person shall have any claim to be granted any Award pursuant to the Plan, and neither the Company nor the Committee is obligated to treat Eligible Individuals, Participants or any other persons uniformly.

15.2 *No Stockholders Rights.* Except as otherwise provided herein, a Participant shall have none of the rights of a stockholder with respect to shares of Stock covered by any Award until the Participant becomes the record owner of such shares of Stock.

15.3 *Withholding.* The Company or any Subsidiary shall have the authority and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, local and foreign taxes (including the Participant's FICA obligation) required by law to be withheld with respect to any taxable event concerning a Participant arising as a result of this Plan. The Committee may in its discretion and in satisfaction of the foregoing requirement allow a Participant to elect to have the Company withhold shares of Stock otherwise issuable under an Award (or allow the return of shares of Stock) having a Fair Market Value equal to the sums required to be withheld. Notwithstanding any other provision of the Plan, the number of shares of Stock which may be withheld with respect to the issuance, vesting, exercise or payment of any Award (or which may be repurchased from the Participant of such Award within six months (or such other period as may be determined by the Committee) after such shares of Stock were acquired by the Participant from the Company) in order to satisfy the Participant's federal,

state, local and foreign income and payroll tax liabilities with respect to the issuance, vesting, exercise or payment of the Award shall be limited to the number of shares which have a

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Fair Market Value on the date of withholding or repurchase equal to the aggregate amount of such liabilities based on the minimum statutory withholding rates for federal, state, local and foreign income tax and payroll tax purposes that are applicable to such supplemental taxable income.

15.4 *No Right to Employment or Services.* Nothing in the Plan or any Award Agreement shall interfere with or limit in any way the right of the Company or any Subsidiary to terminate any Participant's employment or services at any time, nor confer upon any Participant any right to continue in the employment or service of the Company or any Subsidiary.

15.5 *Unfunded Status of Awards.* The Plan is intended to be an unfunded plan for incentive compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Agreement shall give the Participant any rights that are greater than those of a general creditor of the Company or any Subsidiary.

15.6 *Indemnification.* To the extent allowable pursuant to applicable law, each member of the Committee or of the Board shall be indemnified and held harmless by the Company from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such member in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action or failure to act pursuant to the Plan and against and from any and all amounts paid by him or her in satisfaction of judgment in such action, suit, or proceeding against him or her; *provided* he or she gives the Company an opportunity, at its own expense, to handle and defend the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled pursuant to the Company's Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

15.7 *Relationship to other Benefits.* No payment pursuant to the Plan shall be taken into account in determining any benefits pursuant to any pension, retirement, savings, profit sharing, group insurance, welfare or other benefit plan of the Company or any Subsidiary except to the extent otherwise expressly provided in writing in such other plan or an agreement thereunder.

15.8 *Expenses.* The expenses of administering the Plan shall be borne by the Company and its Subsidiaries.

15.9 *Titles and Headings.* The titles and headings of the Sections in the Plan are for convenience of reference only and, in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

15.10 *Fractional Shares.* No fractional shares of Stock shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional shares or whether such fractional shares shall be eliminated by rounding up or down as appropriate.

15.11 *Limitations Applicable to Section 16 Persons.* Notwithstanding any other provision of the Plan, the Plan, and any Award granted or awarded to any Participant who is then subject to Section 16 of the Exchange Act, shall be subject to any additional limitations set forth in any applicable exemptive rule under Section 16 of the Exchange Act (including any amendment to Rule 16b-3 of the Exchange Act) that are requirements for the application of such exemptive rule. To the extent permitted by applicable law, the Plan and Awards granted or awarded hereunder shall be deemed amended to the extent necessary to conform to such applicable exemptive rule.

15.12 *Government and Other Regulations.* The obligation of the Company to make payment of awards in Stock or otherwise shall be subject to all applicable laws, rules, and regulations, and to such approvals by government agencies as may be required. The Company shall be under no obligation to register pursuant to the

Securities Act of 1933, as amended, any of the shares of Stock paid pursuant to the Plan. If the shares paid pursuant to the Plan may in certain circumstances be exempt from registration pursuant to the Securities Act of 1933, as amended, the Company may restrict the transfer of such shares in such manner as it deems advisable to ensure the availability of any such exemption.

15.13 *Governing Law.* The Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of California.

\* \* \* \* \*

I hereby certify that the foregoing Plan was duly adopted by the Board of Directors of Mercury General Corporation on January 28, 2005.

\* \* \* \* \*

I hereby certify that the foregoing Plan was approved by the stockholders of Mercury General Corporation on \_\_\_\_\_, 2005.

Executed on this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

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Corporate Secretary









