PROGRESSIVE CORP/OH/
Form PRE 14A
February 26, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant ¨

Check the appropriate box:

x Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

¨ Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

THE PROGRESSIVE CORPORATION

(Name of Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

¨ Fee paid previously with preliminary materials:

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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

(3) Filing Party:

(4) Date Filed:

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

The Progressive Corporation will hold its Annual Meeting of Shareholders on Friday, April 24, 2009, at 10:00 a.m., local time, at 6671 Beta Drive, Mayfield Village, Ohio, for the following purposes:

1. To elect as directors the four nominees identified in the attached Proxy Statement, each to serve for a term of three years;

2. To approve an amendment to our Code of Regulations to establish procedures for shareholders to make proposals for consideration at our Annual Meetings of Shareholders (other than nominations for directors);

3. To approve an amendment to our Code of Regulations to revise the existing procedures relating to shareholder nominations of directors;

4. To ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for 2009; and

5. To transact such other business as may properly come before the meeting.

The foregoing items of business are described more fully in the Proxy Statement accompanying this Notice. Only shareholders of record of The Progressive Corporation (NYSE:PGR) at the close of business on February 27, 2009, will be entitled to receive notice of and to vote at the meeting or any adjournment thereof.

Your vote is important. Whether or not you plan to be present at the meeting, please vote by Internet or telephone (following the instructions on the enclosed proxy card), or by completing and returning the proxy card in the enclosed postage-paid envelope. If you later choose to revoke your proxy, you may do so before voting occurs at the Annual Meeting by following the procedures described in the Questions and Answers about the Annual Meeting and Voting section in the attached Proxy Statement.

By Order of the Board of Directors.

Charles E. Jarrett, *Secretary*

March __, 2009

The Proxy Statement and the 2008 Annual Report to Shareholders are also available at progressiveproxy.com.

The Progressive Corporation

Proxy Statement

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THE PROGRESSIVE CORPORATION

PROXY STATEMENT

GENERAL INFORMATION REGARDING PROXY MATERIALS AND THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 24, 2009

The Board of Directors of The Progressive Corporation (NYSE:PGR) provides this Proxy Statement to you to solicit your proxy to act upon the matters outlined in the accompanying Notice of Annual Meeting of Shareholders. These include the election of four nominees as directors, the approval of amendments to our Code of Regulations, and the ratification of the appointment of Progressive s independent registered public accounting firm for 2009, each described in more detail below.

The Annual Meeting will take place on Friday, April 24, 2009 at 10:00 a.m., local time, at 6671 Beta Drive, Mayfield Village, Ohio 44143. The proxies also may be voted at any adjournment or postponement of the meeting.

The form of proxy (proxy card), this Proxy Statement and Progressive s 2008 Annual Report to Shareholders are being mailed to shareholders beginning on or about March , 2009.

All properly executed written proxies, and all proxies that are properly completed and submitted over the Internet or by telephone, will be voted at the meeting in accordance with the directions given by the shareholder, unless the shareholder properly revokes his or her proxy before voting occurs at the meeting.

Only shareholders of record of The Progressive Corporation at the close of business on February 27, 2009, the record date, will be entitled to receive notice of and to vote at the meeting or any adjournment thereof. Each shareholder on the record date is entitled to one vote for each of our Common Shares, $1.00 par value, held. On the record date, there were shares of our common stock issued and outstanding.

QUESTIONS AND ANSWERS ABOUT THE ANNUAL MEETING AND VOTING

Why did I receive these materials?

You received these materials because you are a shareholder of Progressive. We hold a meeting of our shareholders annually. This year s meeting will be held on Friday, April 24, 2009. At the meeting, shareholders will be asked to vote on several items of business. Since it is not practical or convenient for all shareholders to attend the meeting in person, our Board of Directors is seeking your proxy to vote on these matters.

What is a proxy?

A proxy is your legal authority for another person to vote the stock you own at our Annual Meeting. The person you designate to vote your shares is referred to as your proxy. If you designate someone as your proxy in a written document, that document is also sometimes referred to as a proxy or proxy card. When you submit a proxy card, the person(s) named as your proxy(ies) on the card are required to vote your shares at the Annual Meeting in the manner you have instructed. By voting via proxy, each shareholder is able to ensure that his or her vote is counted without having to attend the Annual Meeting in person.

Who is soliciting my proxy?

This solicitation of proxies is made by and on behalf of our Board of Directors. The Board has approved the matters to be acted upon at the Annual Meeting (described in more detail below), subject to approval by shareholders. The Board recommends that you vote in favor of each director nominee named in this Proxy Statement and for each of the other proposals. However, you control your vote, and the voting instructions that you provide will be followed.

What is the purpose of the Annual Meeting?

At the Annual Meeting, shareholders will act upon the matters outlined in the Notice of Annual Meeting of Shareholders. These include:

Election of the four nominees identified in this Proxy Statement as directors, each to serve for a term of 3 years;

Approval of amendments to our Code of Regulations to:

- establish procedures for shareholders to make proposals for consideration at our Annual Meetings; and
- revise existing procedures relating to shareholder nominations of directors; and

Ratification of the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for 2009; and

Any other business that properly comes before the meeting.

Also, once the business of the Annual Meeting is concluded, management will comment briefly on the company s performance and will be available to respond to appropriate questions from shareholders. The Annual Meeting will not be accessible via teleconference or webcast.

What is a proxy statement?

This document (including the exhibits, but excluding the 2008 Annual Report to Shareholders, which is attached as an appendix) is our Proxy Statement. The proxy statement is a document that Securities and Exchange Commission (SEC) regulations require us to give shareholders when we are soliciting shareholders proxies to vote their shares. This Proxy Statement and the Annual Report contain important information about The Progressive Corporation and its subsidiaries, and about the matters that will be voted on at the meeting. Please read these materials carefully so that you have the information you need to make informed decisions.

Who is entitled to vote at the Annual Meeting?

Anyone who holds our common stock at the close of business on February 27, 2009, the record date, is entitled to receive the Notice of Annual Meeting and Proxy Statement and to vote his or her shares at the Annual Meeting. As of the record date, there were shares of our common stock outstanding and entitled to vote. Each share of common stock is entitled to one vote on each matter properly brought before the meeting.

What is the difference between a shareholder of record and a shareholder who holds stock in street name ?

If you hold Progressive shares directly in your name with our transfer agent, National City Bank, you are a shareholder of record (also known as a registered shareholder). The Notice of Annual Meeting, Proxy Statement, 2008 Annual Report to Shareholders and proxy card have been sent directly to you by Progressive or our representative.

If you own your shares indirectly through a broker, bank, or other financial institution, your shares are said to be held in street name. Technically, the bank or broker is the shareholder of record with respect to those shares. In this case, the Notice of Annual Meeting, Proxy Statement, Annual Report to Shareholders, and a voting instruction form have been forwarded to you by your broker, bank, other financial institution, or their designated representative. Through this process, your bank or broker collects the voting instructions from all of their respective customers who hold Progressive shares and then submits those votes to us.

What shares are included on the proxy card?

If you are a shareholder of record, you will receive only one proxy card for all the shares of common stock you hold as of February 27, 2009:

- in certificate form (i.e., you hold paper share certificates as evidence of your ownership); and
- in book-entry form (i.e., physical certificates are not issued; includes shares held in a direct registration program or shares of restricted stock held by some of our employees, directors, and former employees).

Employees and former employees who hold shares in The Progressive 401(k) Plan (401(k) Plan) will receive information on the number of shares with which they are eligible to provide voting instructions.

If you hold shares in street name, the voting instruction form that you receive from your bank or broker should include a statement of the number of shares that you are entitled to vote. Any questions concerning this information should be directed to your bank or broker.

What methods can I use to vote?

By Mail. All shareholders of record can vote by written proxy card. Please be sure to complete, sign, and date the proxy card and return it in the enclosed, prepaid envelope. If you are a street name holder, you will receive a voting form and instructions from your bank or broker.

By Telephone or Internet. All shareholders of record also can vote by touch-tone telephone from the U.S. and Canada, using the toll-free telephone number on the proxy card, or through the Internet using the procedures and instructions described on the proxy card.

Telephone and Internet voting for street name holders is typically made available by brokers, banks, or other financial institutions. If applicable to you, voting instructions will be included in the materials you receive from them.

If you vote by telephone or on the Internet, you do not have to return your proxy card or voting instruction form.

In Person. All shareholders of record may vote in person at the Annual Meeting. Street name holders may vote in person at the Annual Meeting only if they bring a legal proxy from their bank or broker. If you are a street name holder and you plan to vote in person, you must request the legal proxy from your bank or broker well in advance of the meeting date.

401(k) Plan Holders. If you hold shares in our 401(k) Plan, you will receive voting instructions from our plan administrator. If voting instructions are received by the plan administrator, they will be voted according to the instructions received. If you do not specify your voting instructions in the manner required by the plan administrator, the administrator will not vote your 401(k) Plan shares. **To allow sufficient time for voting by the 401(k) Plan administrator, your voting instructions must be received by 11:59 p.m. eastern time, on Tuesday, April 21, 2009.** You can change your vote at any time prior to this cut-off time; only your last vote will be counted. Voting in person at the Annual Meeting is not permitted.

Whether or not you plan to attend the Annual Meeting, the Board of Directors strongly encourages you to vote your shares by proxy prior to the meeting. Your vote is important. Please follow the voting instructions carefully to make sure that your shares are voted appropriately. You can save us the expense of a second mailing if you vote your shares promptly.

If I submit a proxy, may I later change or revoke it?

If you are a shareholder of record, you can revoke your proxy before votes are cast at the Annual Meeting by:

- written notice to the Secretary of the company;
- timely delivery of a valid, later-dated and signed proxy card or a later-dated vote by telephone or via the Internet; or
- voting in person at the Annual Meeting.

If you are a street name holder of shares, you may submit new voting instructions by contacting your bank, broker, or other financial institution. You may also vote in person at the Annual Meeting if you obtain a legal proxy as described in the answer to the previous question.

All shares that have been properly voted and not revoked will be voted at the Annual Meeting as instructed.

Who counts the votes?

Votes will be tabulated by or under the direction of the Inspectors of Election, some of whom may be regular employees of Progressive. The Inspectors of Election will certify the results of the voting at the Annual Meeting.

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What are my voting choices when voting for director nominees, and what vote is needed to elect directors?

When you vote on our nominees for the Board of Directors, you will have the following choices:

vote FOR all nominees;

vote AGAINST all nominees;

vote FOR certain nominees, but AGAINST specified nominees; or

ABSTAIN from voting with respect to one or more nominees.

A nominee will be elected if he receives more for votes than against votes. Abstentions will not be counted as a vote for or against the nominee and, therefore, will have no effect on the outcome. Any nominee who does not receive a majority of the votes cast is not elected; if the nominee is a current director, the Board expects that he will submit a resignation for the Board s consideration promptly after the meeting. If the resignation is not submitted within 10 days after the certification of the shareholders vote, his term as a director will automatically expire.

The Board recommends a vote **FOR** each of the nominees.

What are my voting choices when voting on the proposals to amend our Code of Regulations (Items 2 and 3 on the Notice of Annual Meeting above), and what vote is needed to pass the proposals?

For each proposal, you may select from the following choices:

vote FOR the proposal;

vote AGAINST the proposal; or

ABSTAIN from voting on the proposal.

The proposal to amend our Code of Regulations to establish procedures for shareholders to make proposals for consideration at our Annual Meetings of Shareholders (other than nominations for directors) will be adopted if approved by the affirmative vote of a majority of the company s common shares outstanding as of the record date. As such, abstentions and broker non-votes will have the same effect as votes against the proposal.

The proposal to amend our Code of Regulations to revise the existing procedures relating to shareholder nominations of directors will be adopted if approved by the affirmative vote of seventy-five percent (75%) of the company s common shares outstanding as of the record date. Abstentions and broker non-votes will have the same effect as votes against the proposal.

The Board recommends a vote **FOR** each of the proposals.

What are my voting choices when voting on the ratification of the appointment of PricewaterhouseCoopers LLP as the company s independent registered public accounting firm for 2009 (Item 4 below), and what vote is needed to ratify their appointment?

In the vote on the approval of the appointment of PricewaterhouseCoopers LLC as the independent registered public accounting firm for 2009, shareholders may:

- vote FOR the ratification;
- vote AGAINST the ratification; or
- ABSTAIN from voting on the ratification.

This proposal will be adopted if approved by the affirmative vote of a majority of the votes cast on this proposal, provided the total number of votes cast represents a majority of the outstanding common shares. Broker non-votes will not be treated as votes cast. Abstentions will be treated as votes cast and, consequently, will have the same effect as votes against the proposal.

The Board recommends a vote **FOR** the ratification.

What is a broker non-vote?

A broker non-vote occurs when a broker s or bank s customer does not provide the broker or bank with voting instructions on non-routine matters for shares owned by the customer (sometimes referred to as the beneficial owner) but held in the name of the broker or bank. For such matters, the broker or bank cannot vote on behalf of the shareholder and reports the number of such shares as non-votes. By contrast, if a proposal is considered routine, the broker or bank, in its discretion, may vote any shares as to which it has not received specific instructions from its customer. Whether the proposal is non-routine or routine is governed by the rules of the New York Stock Exchange (NYSE). All proposals included in this Proxy Statement are considered routine by the NYSE.

What if I do not specify a choice for a matter when returning a proxy?

You should specify your choice for each matter on the enclosed proxy card. For shareholders of record, if no specific instructions are given, proxies that are signed and returned will be voted in accordance with the recommendations of the Board of Directors, as follows:

FOR the election of all four director nominees, each for a term of 3 years;

FOR the proposal to amend our Code of Regulations to establish procedures for shareholders to make proposals for consideration at our Annual Meetings of Shareholders (other than nominations for directors);

FOR the proposal to amend our Code of Regulations to revise the existing procedures relating to shareholder nomination of directors; and

FOR the proposal to ratify the appointment of PricewaterhouseCoopers LLP as the company s independent registered public accounting firm for 2009.

Can I access the Notice of Annual Meeting, Proxy Statement, Annual Report on Form 10-K and the Annual Report to Shareholders on the Internet?

The Notice of Annual Meeting, Proxy Statement and 2008 Annual Report to Shareholders are available on a dedicated Web site at progressiveproxy.com. Our Annual Report on Form 10-K is available at the Investor Relations section of our Web site at progressive.com/sec. We will also provide a copy of any of these documents to any shareholder free of charge, upon request by e-mail to investor_relations@progressive.com, by calling toll-free 1-800-542-1061, or by writing to: The Progressive Corporation, Investor Relations, 6300 Wilson Mills Road, Box W33, Mayfield Village, Ohio 44143.

Street Name Holders. If you hold your shares in a bank or brokerage account, your bank or broker may also provide you copies of these documents electronically. Please check the information provided in the proxy materials mailed to you by your bank or broker regarding the availability of this service.

ITEM 1: ELECTION OF DIRECTORS

Four of our directors have been nominated for re-election this year. Information about the structure of our Board of Directors and about our individual directors follows.

Progressive s Code of Regulations provides that the number of directors shall be fixed at no fewer than five and no more than 13. The number of directors has been fixed by shareholders at 13, and there are currently 12 directors on the Board and one vacancy. The Code of Regulations also provides that the directors are to be divided into three classes as nearly equal in number as possible and that the classes are to be elected for staggered terms of three years each. Directors of one class are elected annually, except as provided below. At the Annual Meeting, the shares represented by the proxies obtained hereby, unless otherwise specified, will be voted for the election as directors of the four nominees named below, each to serve for a three-year term, and until their respective successors are duly elected. If, by reason of death or other unexpected occurrence, any one or more of the nominees named below is not available for election, the proxies will be voted for such substitute nominee(s), if any, as the Board of Directors may propose.

Based upon a recommendation from the Board s Nominating and Governance Committee, the Board has nominated the four nominees named below for re-election to the Board. No shareholder nominations for the election of directors have been received within the time period specified by Section 13 of Article II of our Code of Regulations, and no shareholder nominations were received pursuant to our Shareholder-Proposed Candidate Procedures (discussed below). Proxies cannot be voted at the Annual Meeting for a greater number of persons than the four nominees named in this Proxy Statement.

If written notice is given by any shareholder to the President, a Vice President or the Secretary not less than 48 hours before the time fixed for holding the Annual Meeting that he or she desires that the voting for election of directors shall be cumulative, and if an announcement of the giving of such notice is made at the meeting by the Chairman or Secretary or by or on behalf of the shareholder giving such notice, each shareholder shall have the right to cumulate his or her voting power in the election of directors. Under cumulative voting, each shareholder may give one nominee a number of votes equal to the number of directors to be elected multiplied by the number of shares he or she holds, or distribute such number of votes among two or more nominees, as the shareholder sees fit. If the enclosed proxy is executed and returned and voting for the election of directors is cumulative, the persons named in the enclosed proxy will have the authority to cumulate votes and to vote the shares represented by such proxy, and by other proxies held by them, so as to elect as many of the four nominees named below as possible.

Under changes to our organizational documents approved by shareholders in 2008, a nominee for director in an uncontested election will be elected as a director only if he or she receives a majority of the votes cast, which is sometimes referred to as a majority voting standard. If the election for directors is contested (that is, there are more nominees than the number of director positions up for election), the majority voting standard does not apply, and the nominees receiving the highest number of votes will be elected (a plurality voting standard). The election of directors at this year s Annual Meeting is an uncontested election, so each nominee must receive a majority of the votes cast to be elected.

Each of the four nominees for director is currently a director of the company. If an incumbent director is not re-elected by shareholders in an uncontested election, the director is not automatically removed from the Board, but he or she is expected by the Board of Directors to tender a resignation from the Board within 10 days after the certification of the shareholder vote. If that resignation is not made contingent on the Board s determination to accept or reject such resignation, the resignation will be effective immediately. If the resignation is contingent on Board action, the Board will review the resignation under procedures approved by the Board and announce its determination whether to accept or reject the resignation within 120 days from the certification of the shareholder vote. If a director is not elected by majority vote, but fails to tender his or her resignation during the 10-day period after certification, his or her term of office will expire automatically upon the expiration of the 10 days.

The Board currently has one vacancy. Under our Code of Regulations, the Board has the right to elect a new director to fill such a vacancy, but the new director so elected would serve for a term that expires on the date of the next shareholder meeting at which directors are to be elected. No decision has been made to fill the vacancy at this time.

The following information is provided for each person nominated for election as a director and for those directors whose terms will continue after the Annual Meeting. Unless otherwise indicated, each such nominee or director has held the principal occupation indicated for more than the last five years.

Nominees for Election at the Annual Meeting

Name	Age	Principal Occupation and Last Five Years Business Experience	Other Directorships	Director Since	If Elected, Term Expires
Roger N. Farah	56	President, Chief Operating Officer and Director, Polo Ralph Lauren Corporation, New York, New York (lifestyle products)	Aetna, Inc.	2008	2012
Stephen R. Hardis	73	Non-Executive Chairman of the Board, Marsh & McLennan Companies, Inc., New York, New York (financial services) since May 2006; Lead Director, Axcelis Technologies, Inc., Beverly, Massachusetts (semiconductor equipment manufacturing) since May 2005; Chairman of the Board, Axcelis Technologies, Inc. prior to May 2005	Axcelis Technologies, Inc., Lexmark International, Inc., Marsh & McLennan Companies, Inc., and Nordson Corporation	1988	2012
Norman S. Matthews	76	Consultant, New York, New York	Finlay Enterprises, Inc. and Henry Schein, Inc.	1981	2012
Bradley T. Sheares, Ph.D.	52	Former Chief Executive Officer, Reliant Pharmaceuticals, Inc., Liberty Corner, New Jersey (pharmaceutical products) from January 2007 to December 2007; President, U.S. Human Health Division of Merck & Co., Inc., Whitehouse Station, New Jersey (pharmaceutical products and services) prior to July 2006	Covance Inc. and Honeywell International, Inc.	2003	2012

Directors Whose Terms will Continue after the Annual Meeting

Name	Age	Principal Occupation and Last Five Years Business Experience	Other Directorships	Director Since	Term Expires
Peter B. Lewis	75	Non-Executive Chairman of the Board of The Progressive Corporation	None	1965	2010
Patrick H. Nettles, Ph.D.	65	Executive Chairman of the Board, Ciena Corporation, Linthicum, Maryland (telecommunications)	Axcelis Technologies, Inc. and Ciena Corporation	2004	2010
Glenn M. Renwick	53	President and Chief Executive Officer of The Progressive Corporation; President, Chairman of the Board and Chief Executive Officer of Progressive Casualty Insurance Company (a Progressive subsidiary) prior to April 2004; officer and director of various other subsidiaries and an affiliate of Progressive	Fiserv, Inc. and UnitedHealth Group Incorporated	1999	2010
Donald B. Shackelford	76	Retired since March 2008; Chairman of the Board, Fifth Third Bank, Central Ohio (successor to State Savings Bank), Columbus, Ohio (commercial banking) prior to March 2008	Diamond Hill Investment Group, Inc.	1976	2010

Name	Age	Principal Occupation and Last Five Years Business Experience	Other Directorships	Director Since	Term Expires
Charles A. Davis	60	Chief Executive Officer, Stone Point Capital LLC, Greenwich, Connecticut (global private equity firm) since June 2005; Chairman and CEO, MMC Capital, Inc., Greenwich, Connecticut (global private equity firm) prior to June 2005; Vice Chairman, Marsh & McLennan Companies, Inc., New York, New York (financial services) prior to December 2004	AXIS Capital Holdings Limited and The Hershey Company	1996	2011
Bernadine P. Healy, M.D.	64	Health Editor and Medical Columnist, U.S. News & World Report, Washington, D.C. (publishing)	Ashland Inc. and Invacare Corporation	2002	2011
Jeffrey D. Kelly	55	Former Chief Financial Officer, National City Corporation (NCC), Cleveland, Ohio (commercial banking) prior to September 2008; Vice Chairman of NCC from December 2004 to September 2008; Executive Vice President of NCC prior to December 2004	None	2000	2011
Abby F. Kohnstamm	55	President and Chief Executive Officer, Abby F. Kohnstamm & Associates, Inc., New York, New York (marketing consulting firm) since January 2006; Senior Vice President of Marketing, IBM Corporation, Armonk, New York (information technology) prior to December 2005	Tiffany & Co.	2006	2011

OTHER BOARD OF DIRECTORS INFORMATION

Board of Directors Independence Standards and Determinations

Determinations under Categorical Standards. The Board of Directors has approved categorical independence standards which, if satisfied by a director, will permit a determination that such director is independent for purposes of the NYSE Listing Standards. Under Progressive s standards, an individual director may be determined to be independent only if he or she satisfies each of the following requirements, or if he or she is otherwise determined to be independent by a disinterested majority of the Board as provided below:

He or she is not currently an officer or employee of The Progressive Corporation or any of its subsidiaries, and has not been an officer or employee of Progressive or any of its subsidiaries at any time during the past three years. For purposes of this requirement, officer does not include a non-executive Chairman of the Board who is otherwise independent under these standards.

No member of his or her immediate family is an executive officer of Progressive or has been an executive officer of Progressive at any time during the past three years.

Neither he or she, nor any member of his or her immediate family, receives, or has received payments or other consideration from the company or any of its subsidiaries in excess of $120,000, in the aggregate, during any twelve-month period within the past three years, either

- as direct compensation. For this purpose, direct compensation excludes: (i) retainer and meeting fees and equity grants for service as a director, (ii) pension or other forms of deferred compensation for prior service (provided such compensation is not contingent on continued service), or (iii) compensation received by an immediate family member for service as an employee of Progressive (other than as an executive officer); or

- in connection with any direct business relationship between such individual and the company or any of its subsidiaries. For this purpose, a direct business relationship means the purchase or sale for value of any goods or services (other than insurance products sold by the company and related services), including, without limitation, consulting or advisory services.

He or she (i) is not currently a partner or employee of a firm that is Progressive s internal or external auditor, and (ii) was not at any time within the past three years a partner or employee of such a firm who personally worked on Progressive s audit during that time.

No member of his or her immediate family (i) is currently a partner in a firm that is Progressive s internal or external auditor, (ii) is currently an employee of such firm who personally works on the company s audit, or (iii) was at any time within the past three years a partner or employee of such firm and personally worked on Progressive s audit during that time.

Neither he or she, nor any member of his or her immediate family, is or has been at any time during the past three years, employed as an executive officer of another company where any of the present executive officers of Progressive at the same time serves or served on the compensation committee of such other company.

He or she is not an attorney or a member of, partner in, or of counsel to, any law firm that, Progressive has retained during the last fiscal year or proposes to retain during the current fiscal year; no member of his or her immediate family is an attorney who the company has retained during the last fiscal year or proposes to retain during the current fiscal year; and no member of his or her immediate family is a member of, or of counsel to, any law firm that the company has retained and paid legal fees to in excess of $120,000 during the last fiscal year.

Neither he or she, nor any member of his or her immediate family, is a partner or executive officer of any investment banking firm that has performed services for Progressive (other than as a participating underwriter in a syndicate) during the last fiscal year or that Progressive proposes to have perform such services during the current fiscal year.

He or she is not a current employee of, and no member of his or her immediate family is a current executive officer of, and neither he or she nor any member of his or her immediate family holds a one percent or greater equity interest in, any other company or organization that has, or had at any time within the past three years, a material business or other relationship with Progressive or any of its subsidiaries. For purposes of this standard, a relationship will be deemed to be material if the total amount of the payments made or received by Progressive or any of its subsidiaries in connection with such business or other relationship during the relevant fiscal year was more than the greater of (i) $1 million, or (ii) two percent of the consolidated gross revenues of such other entity.

Contributions by Progressive to a charitable or non-profit organization in which a director or his or her spouse serves as a director, trustee, or executive officer or in an equivalent position will be deemed immaterial under these standards if Progressive s contributions to such organization in any calendar year do not exceed $25,000 (excluding matching gifts made by The Progressive Insurance Foundation in response to employee contributions to such organization). If Progressive makes annual contributions in excess of the stated amount to any such organization, the effect, if any, on the director s independence will be considered on a case-by-case basis.

If a director has one or more relationships with Progressive that fall outside of our categorical standards, the materiality of such other relationships will be determined by a disinterested majority of directors on a case-by-case basis. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others. The ownership of even a significant amount of stock, by itself, however, is not a bar to a finding of independence.

The Board of Directors has considered the independence of each of the directors under the foregoing standards and, based on such considerations and the recommendations of the Nominating and Governance Committee, and after due inquiry into the facts and circumstances of each director s relationships with Progressive (if any), has determined that each of our current directors, with the exception of Glenn M. Renwick as discussed further below, (i) satisfies Progressive s independence standards as described above, (ii) has no relationship with Progressive or its subsidiaries or with any charitable organization that received a contribution from Progressive that would require an individual determination as to such director s independence, and (iii) is independent under the applicable NYSE Listing Standards.

Mr. Glenn M. Renwick is not independent by virtue of his position as Progressive s current President and Chief Executive Officer.

Meetings of the Board of Directors and Attendance

The Board of Directors held six meetings during 2008.

All of the current directors were on the Board throughout 2008, except Mr. Roger N. Farah, who was appointed as a director in June 2008. All directors attended more than 75% of their scheduled Board and Committee meetings.

Pursuant to our Corporate Governance Guidelines, directors are expected to attend our Annual Meeting of Shareholders. Normally, a meeting of the Board will be scheduled on the date of the Annual Meeting. Progressive s 2008 Annual Meeting of Shareholders was attended by 10 out of 11 of its then current directors. A full copy of our Corporate Governance Guidelines can be found on our Web site at progressive.com/governance, or may be requested in print by writing to: The Progressive Corporation, Investor Relations, 6300 Wilson Mills Road, Box W33, Mayfield Village, Ohio 44143.

Meetings of the Non-Management Directors

Pursuant to Progressive s Corporate Governance Guidelines, our non-management directors meet in executive session at least quarterly. Each such meeting also constitutes a meeting of our independent directors. The Chairman of the Board, provided that he or she is not an executive officer of Progressive, presides at these meetings. In the event that a non-executive Chairman is not available to lead these meetings, the presiding director would be chosen by the non-management directors in attendance. In 2008, the non-management directors met in executive session six times.

Board Committees

The Board has named an Executive Committee, an Audit Committee, a Compensation Committee, an Investment and Capital Committee, and a Nominating and Governance Committee, as described below. The complete written charters for each of the Committees (other than the Executive Committee, which does not have a charter) can be found on our Web site at progressive.com/governance, or may be requested in print by writing to: The Progressive Corporation, Investor Relations, 6300 Wilson Mills Road, Box W33, Mayfield Village, Ohio 44143.

Executive Committee

Mr. Lewis (Chairman), and Messrs. Hardis, Kelly, and Renwick are the current members of the Board s Executive Committee, which exercises all powers of the Board between Board meetings, except the power to fill vacancies on the Board or its Committees. During 2008, the Executive Committee participated in one conference call, and adopted resolutions by written action pursuant to

Ohio corporation law on eight occasions.

Audit Committee

Mr. Hardis (Chairman), Dr. Healy, Ms. Kohnstamm, and Dr. Nettles are the current members of the Board s Audit Committee, which assures that the organizational structure, policies, controls, and systems are in place to monitor performance. The Audit Committee monitors the integrity of Progressive s financial statements, our financial reporting processes, internal control over financial reporting, and the public release of financial information, and oversees our compliance and ethics and risk management programs. The Committee also is responsible for confirming the independence of, and the selection, appointment, compensation, retention, and oversight of the work of, our independent registered public accounting firm. The Committee provides an independent channel to receive appropriate communications from employees, shareholders, auditors, legal counsel, bankers, consultants, and other interested parties. The Board of Directors has determined that each of the members of the Audit Committee has no relationship to Progressive that may interfere with the exercise of his or her independence from management and Progressive, and is independent as defined in the applicable Securities and Exchange Commission (SEC) rules and NYSE Listing Standards. During 2008, the Audit Committee met in person five times and participated in five conference calls to review our financial and operating results.

Audit Committee Financial Expert. The Board of Directors has determined that Mr. Stephen R. Hardis, the Chairman of the Audit Committee, is an audit committee financial expert, as that term is defined in the applicable SEC regulations, and that he has accounting or related financial management expertise, as required by the NYSE Listing Standards. Mr. Hardis is a former Chairman and Chief Executive Officer of Eaton Corporation, where he served as Chief Financial and Administrative Officer before becoming CEO. He has served on the audit committees of a number of public companies through the years, including as a member of Progressive s Audit Committee from April 1988 through December 1999 and as Chairman from December 2007 to the present. The Board has determined that through appropriate education and experience, Mr. Hardis has demonstrated that he possesses the following attributes:

- An understanding of accounting principles generally accepted in the United States of America and financial statements;
- The ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves;
- Experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and level of complexity that can reasonably be expected to be raised by Progressive s financial statements, or experience actively supervising one or more persons engaged in such activities;
- An understanding of internal control over financial reporting; and
- An understanding of audit committee functions.

Compensation Committee

Dr. Sheares (Chairman), and Messrs. Farah and Matthews are the current members of the Board s Compensation Committee. During 2008, the Compensation Committee met five times in person and one time by phone, and adopted resolutions by written action pursuant to Ohio corporation law on six occasions.

The Committee makes all final determinations regarding executive compensation, including salary, equity (restricted stock awards), and non-equity incentive compensation (cash incentive) targets, and related performance goals, formulae, and procedures. The Committee (or in certain circumstances, the full Board of Directors, based on the Committee s recommendation) also approves the terms of the various compensation and benefit plans in which executive officers and other employees may participate. Committee decisions are made after considering compensation data from comparable companies obtained by Progressive from independent third parties, internal analyses and/or recommendations presented by management. The executive compensation decisions represent the culmination of extensive analysis and discussion, which typically take place over the course of multiple Committee meetings and in meetings between the Committee and management, including our Chief Executive Officer, our Chief Human Resource Officer, members of the Compensation and Law Departments, and other Progressive personnel. In addition, the Committee frequently reports to the full Board of Directors on executive compensation matters.

The Committee s determinations regarding incentive compensation for executive level employees (for example, performance criteria and standards relating to annual cash bonus determinations) also apply to incentive plans covering non-executive employees. Under this arrangement, executives and non-executives alike are motivated to achieve the same performance objectives. The Committee has delegated to management, however, the authority to implement such plans, and make other compensation-related decisions (such as salary and restricted stock awards), for non-executive level employees.

The Committee has the authority under its Charter to hire its own compensation consultants, at Progressive s expense. The Committee regularly assesses the need for a consultant, most recently considering the issue in January 2009. The Committee decided that a consultant would not be hired at that time, in view of Progressive s consistent compensation program and the availability of credible market data from independent third parties, among other factors. The Committee has clearly indicated that it remains open to hiring a consultant in the future and will reconsider the issue from time to time. For more information on executive compensation, see the Compensation Discussion and Analysis section beginning on page 20.

Investment and Capital Committee

Mr. Kelly (Chairman), and Messrs. Davis, Lewis, and Shackelford are the current members of the Board s Investment and Capital Committee. The Investment Committee s responsibilities include monitoring: whether the company has adopted and adheres to a rational and prudent investment and capital management policy; whether management s investment and capital management actions are consistent with the company s investment policy, financial objectives and business goals; the company s compliance with legal and regulatory requirements pertaining to investment and capital management; the competence, performance, and compensation of the company s internal and external money managers; and such other matters as the Board or the Committee deems appropriate. The Committee does not make operating decisions about money manager selection or compensation, asset allocation, market timing, sector rotation, or security selection, which are the responsibilities of management. The full Board of Directors must approve significant changes to the company s capital structure, dividend policy, or portfolio asset allocation. During 2008, the Investment and Capital Committee met five times. In addition to the Committee meetings, Mr. Kelly and Mr. William M. Cody, our Chief Investment Officer, generally held monthly conversations to discuss the status of the company s investments and capital.

Nominating and Governance Committee

Mr. Matthews (Chairman), and Messrs. Davis and Hardis are the current members of the Board s Nominating and Governance Committee. The Committee considers the qualifications of individuals who are proposed as possible nominees for election to the Board and makes recommendations to the Board with respect to such potential candidates. The Committee recommended Roger N. Farah to fill a vacancy on the board in June 2008, and he was elected by the Board at that time. In addition, the committee recommended each of Mr. Farah and the three other nominees named in this Proxy Statement for re-election to the Board at our Annual Meeting of Shareholders.

The Committee also is responsible for monitoring corporate governance matters as they affect the Board and the company. The Committee regularly reviews Progressive s Corporate Governance Guidelines and related matters to ensure that they continue to correspond to and support the Board s governance philosophy. The Committee considers and, where appropriate, recommends to the Board for approval, changes to the Corporate Governance Guidelines based on suggestions from Board members or management.

During 2008, the Nominating and Governance Committee met four times. The Committee regularly reviews the qualifications of potential candidates for the Board. The Committee recommended the four nominees named above, each of whom is currently a director, for re-election to the Board.

Shareholder-Proposed Candidate Procedures. Pursuant to the Nominating and Governance Committee s Charter, the Board has adopted a policy of considering director candidates who are recommended by Progressive s shareholders. In addition, the Committee has adopted Procedures for Shareholders to Propose Candidates for Directors (the Shareholder-Proposed Candidate Procedures or Procedures).

Any shareholder desiring to propose a candidate for election to the Board under these Procedures may do so by mailing to Progressive s Secretary a written notice identifying the candidate. The written notice must also include the supporting information required by the Shareholder-Proposed Candidate Procedures, the complete text of which can be found on our Web site at progressive.com/governance. The notice and supporting information should be sent to the Secretary at the following address: Charles E. Jarrett, Secretary, The Progressive Corporation, 6300 Wilson Mills Road, Mayfield Village, Ohio 44143. Upon receipt, the Secretary will forward the notice, and the other information provided, to the Committee.

If a shareholder proposes a candidate without submitting all of the foregoing items, the Committee, in its discretion, may reject the proposed candidate, request more information from the nominating shareholder, or consider the proposed candidate while reserving the right to request more information. In addition, the Committee may further limit each shareholder to one proposed candidate in any calendar year and may refuse to consider any additional candidate(s) proposed by such shareholder or its affiliates during the calendar year.

Shareholders may propose candidates to the Committee pursuant to the Shareholder-Proposed Candidate Procedures at any time. However, to be considered by the Committee in connection with Progressive s next Annual Meeting of Shareholders (held in April of each year), the Secretary must receive the shareholder s proposal and the information required above on or before November 30th of the year immediately preceding such Annual Meeting.

It is the Committee s policy to review and evaluate each candidate for nomination submitted by shareholders in accordance with the Shareholder-Proposed Candidate Procedures on the same basis as candidates who are suggested by our Board members, executive officers, or other sources, which may include professional search firms retained by the Committee. The Committee will give strong preference to candidates who are likely to be deemed independent from Progressive under SEC and NYSE rules. As to shareholder-proposed candidates, the Committee may give more weight to candidates who are unaffiliated with the shareholder proposing their nomination and to candidates who are proposed by long-standing shareholders with significant share ownership (i.e., greater than 1% of Progressive s common shares that have been owned for more than two years).

In considering director nominations, the Committee will consider: the current composition of the Board and how it functions as a group; the talents, personalities, strengths, and weaknesses of current Board members; the value of contributions made by individual Board members; the need for a person with specific skills, experiences, or background to be added to the Board; any available or anticipated vacancies due to retirement or other reasons; and other factors which may enter into the nomination decision. Upon the expiration of a director s term on the Board, that director will be given preference for nomination when the director indicates his or her willingness to continue serving and, in the Committee s judgment, the director has made, and is likely to continue to make, significant contributions to the Board and Progressive.

When considering an individual candidate s suitability for the Board, the Committee will evaluate each individual on a case-by-case basis. The Committee does not prescribe minimum qualifications or standards for directors, but instead looks for directors who have demonstrated the ability to satisfy the fundamental criteria set forth in the Committee s Charter integrity, judgment, commitment, preparation, participation, and contribution. In addition, the Committee will review the extent of the candidate s demonstrated excellence and success in his or her chosen business, profession, or other career and the skills and talents that the candidate would be expected to add to the Board. The Committee may choose, in individual cases, to conduct interviews with the candidate and/or contact references, business associates, other members of boards on which the candidate serves or other appropriate persons to obtain additional information. Such background inquiries may also be conducted, in whole or in part, on the Committee s behalf by third parties, such as professional search firms. The Committee will make its determinations on whether to nominate an individual candidate based on the Board s then-current needs, the merits of that candidate and the qualifications of other available candidates. If a candidate is not nominated, the Committee will have the discretion to reconsider his or her candidacy in connection with future vacancies on the Board.

The Committee s decision not to nominate a particular individual for election to the Board will not be publicized by Progressive, unless required by applicable laws or NYSE rules. The Committee will have no obligation to respond to shareholders who propose candidates that the Committee has determined not to nominate for election to the Board, but the Committee may choose to do so in its sole discretion.

These Shareholder-Proposed Candidate Procedures are in addition to any rights that a shareholder may have under our Code of Regulations or under any applicable laws or regulations in connection with the nomination of directors for our Board.

Communications with the Board of Directors

The Board of Directors has adopted procedures for shareholders to send written communications to the Board as a group. Such communications must be clearly addressed to the Board of Directors and sent to either of the following, at the election of the shareholder:

Peter B. Lewis, Chairman of the Board, The Progressive Corporation, 6300 Wilson Mills Road, Mayfield Village, Ohio 44143 or e-mail: peter_lewis@progressive.com.

Charles E. Jarrett, Secretary, The Progressive Corporation, 6300 Wilson Mills Road, Mayfield Village, Ohio 44143 or e-mail: chuck_jarrett@progressive.com.

In addition, interested parties may contact the non-management directors as a group by sending a written communication to either of the above-named individuals. Such communication must be clearly addressed to the non-management directors.

The recipient will promptly forward communications so received to the full Board of Directors or to the non-management directors, as specified by the shareholder.

Certain Relationships and Related Transactions

Transactions between The Progressive Corporation or its subsidiaries and any director or executive officer, or any entity in which one or more of our directors or executive officers is a substantial owner, director, or executive officer, must be disclosed to and, if appropriate, approved by, our Board of Directors. Our Code of Business Conduct and Ethics prohibits directors and executive officers from having a direct or indirect financial interest in any transaction involving Progressive, unless either: (i) the transaction is disclosed to and approved by a disinterested majority of the Board; or (ii) with respect to a transaction with another publicly held company, the transaction and the Progressive person s status as a director, officer, consultant, or advisor to such other company are known to the Board, a disinterested majority of the Board does not object to the person s continued service to such other public company, and the annual payments to or from Progressive under the transaction do not exceed the lesser of 1% of Progressive s or such other company s consolidated revenues.

This policy is carried out by the Secretary of the company as transactions with such persons or entities, or proposals for such transactions, are identified by management or disclosed by members of the Board. If a transaction with any such person or entity is proposed or entered into during the course of the year, the transaction is presented to the Board for consideration, typically at its next meeting. In addition, all previously approved transactions that are expected to continue into a new year are presented to the Board for review on an annual basis at the Board s first meeting of the year (in January or February). This procedure further allows the Board to consider these relationships at the same time that it is considering whether directors are independent under applicable rules and regulations.

The following discussion sets forth the relationships and transactions known by management at this time to involve Progressive or its subsidiaries and such persons or entities. In each case, pursuant to the policies described above, these transactions have been disclosed to the Board of Directors and a disinterested majority of the Board approved the transaction or, in the case of ongoing relationships that were presented to the Board, permitted the continuation or renewal of the relationship.

Mr. Jeffrey D. Kelly, a director of Progressive, was the Vice Chairman and Chief Financial Officer of National City Corporation, the parent company of National City Bank (NCB) prior to September 2008. Dr. Bernadine P. Healy, a director of Progressive, was also a director of National City Corporation prior to its acquisition by The PNC Financial Service Group Inc. (PNC) on December 31, 2008. NCB is the Transfer Agent and Registrar for our common shares and received fees of $91,055 for such services for 2008. Additionally, we use NCB for commercial banking services and paid $1,224,943 to NCB in service charges during 2008. In each case, these charges represented NCB s customary rates.
Prior to NCB s acquisition by PNC, we had an uncommitted line of credit with NCB in the principal amount of $125 million. We did not incur any commitment fees for this arrangement and no borrowings were outstanding at any time during 2008.

We have established a $40 million trust on behalf of the policyholders of a nonconsolidated affiliate of Progressive, with NCB as trustee, in order to maintain the A.M. Best rating of the nonconsolidated affiliate. We incur an annual trustee fee of $15,000 in connection with this trust, which represents NCB s customary rates.

Mr. Stephen R. Hardis, a director of Progressive, is also a director and Non-executive Chairman of Marsh & McLennan Companies, Inc. (Marsh). Progressive pays commissions to various subsidiaries of Marsh for brokerage services in the ordinary course of our auto and non-auto insurance businesses, at customary rates for the services rendered. During 2008, we paid $967,493 for these services.
During 2008, we also paid $15,491 to a division of Mercer Management Consulting, Inc. (Mercer), a subsidiary of Marsh, for compensation and benefits surveys and related services. The fees paid to Mercer were customary rates for the products purchased or services rendered.

Mr. Charles A. Davis, a director of Progressive, serves as a director of AXIS Capital Holdings Limited (AXIS). During 2008, AXIS reinsured part of the policies we wrote for our outstanding risks under our directors and officers liability insurance, trust errors and omissions insurance, and bond products. AXIS provides reinsurance coverage of $2.8 million on policy limits of $15 million, for losses incurred in excess of the first $1 million. During 2008, we ceded $2,385,859 in premiums to AXIS, and collected $886,683 on paid losses related to this coverage. At December 31, 2008, we had $2,762,482 of reinsurance recoverables on unpaid losses under this arrangement. AXIS is one of several companies that we use to reinsure this non-auto line of business. The terms of this reinsurance arrangement with AXIS are consistent with those between us and the other reinsurers.

Mr. Glenn M. Renwick, President, Chief Executive Officer, and a director of Progressive, is also a director of Fiserv, Inc. We paid $36,536 to Fiserv, Inc. or its subsidiaries, for comparative rating software during 2008. These charges represent the customary rates for the products purchased. During 2008, an investment fund managed by Stone Point Capital, LLC acquired a 51% interest in the Fiserv, Inc. business from which we license this software. Charles A. Davis, a director of Progressive, is the Chief Executive Officer of Stone Point Capital, LLC.

We purchased various health insurance related products and services from Aetna, Inc., in 2008. Mr. Roger N. Farah is a director of Aetna. In 2008, we paid $104,400 for such products and services.

A company owned by Mr. Peter B. Lewis, non-executive Chairman of the Board, subleases space at an airplane hangar leased by one of our subsidiaries, to house the airplane owned by Mr. Lewis s company and related personnel and equipment. The sublease has a 5-year term that commenced in October 2006, and Mr. Lewis s company has options to extend the sublease for three additional 5-year terms. Under the sublease, Mr. Lewis s company rents approximately two-thirds of the hangar space and one-half of the office space at the facility, and it further reimburses one-half of other occupancy costs (such as common area maintenance, insurance, taxes, etc.) and one-half of certain construction and capital expenses. In addition, Mr. Lewis s company reimburses Progressive for fuel for its aircraft, based on actual fuel used, plus one-half of the fuel flow fee incurred by us under our lease for the hangar. During 2008, Mr. Lewis s company paid Progressive s subsidiary a total of $259,931 for fuel and $152,471 for rent and other occupancy expenses in accordance with the terms of the sublease.

The following relatives of executive officers and directors worked for Progressive in 2008: the brother of Brian Domeck (CFO), John Domeck, as an attorney; and the son-in-law of Mr. Hardis (director), Stephen Ware, who works in our information technology area. The dollar value of each of these employment relationships for 2008 was less than $181,000. In determining the dollar value of these relationships, we used the same methodology that is used to determine compensation for named executive officers in the Summary Compensation Table below, under which total compensation includes, to the extent applicable to each individual, salary paid in 2008, Gainsharing and other cash bonuses earned in 2008, restricted stock expense recognized by Progressive during the year, company-matching contributions to our 401(k) Plan and other compensation, but excludes health and welfare benefits that are available generally to all salaried employees, as contemplated by the applicable regulations. In each case, we believe that the level of compensation is appropriate in view of the individual s position, responsibilities, and experience and is consistent with our companywide compensation structure.

Compensation Committee Interlocks and Insider Participation

Dr. Sheares and Messrs. Davis, Farah, and Matthews served as members of Progressive s Compensation Committee during 2008. There are no Compensation Committee interlocks.

REPORT OF THE AUDIT COMMITTEE

The following Report of the Audit Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Progressive filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent Progressive specifically incorporates this Report by reference therein.

The Audit Committee of the Board of Directors (the Committee) oversees Progressive s financial reporting process on behalf of the Board. Progressive s management has the primary responsibility for the financial statements and the reporting process, including the systems of internal control. In fulfilling its oversight responsibilities, the Committee reviewed and discussed with management Progressive s audited financial statements for the year ended December 31, 2008, including a discussion of the quality, not just the acceptability, of the accounting principles, reasonableness of significant judgments and clarity of disclosures in the financial statements.

The Committee has discussed with PricewaterhouseCoopers LLC (PWC), Progressive s independent registered public accounting firm, which is responsible for expressing an opinion on the conformity of the financial statements with accounting principles generally accepted in the United States of America, PWC s judgment as to the quality, not just the acceptability, of Progressive s accounting principles and such other matters as are required to be discussed with the Committee under Statement on Auditing Standards No. 61, as amended, Communication with Audit Committees, as adopted by the Public Company Accounting Oversight Board. In addition, the Committee has received the written disclosures and letter from PWC required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant s communications with the Committee concerning independence, and has discussed with PWC their independence.

The Committee discussed with Progressive s internal auditors and PWC the overall scope and plans for their respective audits. The Committee meets with the internal auditors and PWC, with and without management present, to discuss the results of their examinations, evaluations of Progressive s internal controls and the overall quality of Progressive s financial reporting. During 2008, the Committee held five meetings and participated in five conference calls to review Progressive s financial and operating results and conduct other business. Also, during 2008, the Committee reassessed the adequacy of the Audit Committee Charter, recommended certain minor modifications to the Charter and approved the Charter, as so modified, and recommended that the Charter be submitted for approval to the full Board of Directors. The Board approved the Charter, as so modified, on December 12, 2008, and it became effective as of January 1, 2009. A copy of the Charter, as so approved, is available on our Web site at progressive.com/governance.

Based on the reviews and discussions referred to above, the Committee recommended to the Board of Directors that the audited financial statements be included in The Progressive Corporation s Annual Report on Form 10-K for the year ended December 31, 2008, for filing with the Securities and Exchange Commission.

The Committee has selected and retained PWC to serve as the independent registered public accounting firm for Progressive and its subsidiaries for 2009. Shareholders will be given the opportunity to express their opinion on ratification of this selection at the 2009 Annual Meeting of Shareholders.

On April 18, 2008, Abby F. Kohnstamm joined the Audit Committee. Ms. Kohnstamm is President and Chief Executive Officer of Abby F. Kohnstamm & Associates, Inc., a New York-based marketing consulting firm, and has been a member of Progressive s Board of Directors since 2006.

AUDIT COMMITTEE

Stephen R. Hardis, *Chairman*

Bernadine P. Healy, M.D.

Abby F. Kohnstamm

Patrick H. Nettles, Ph.D.

SECURITY OWNERSHIP OF CERTAIN

BENEFICIAL OWNERS AND MANAGEMENT

Security Ownership of Certain Beneficial Owners

The following information is set forth with respect to persons known to management to be the beneficial owners, as of December 31, 2008, of more than 5% of Progressive s Common Shares, $1.00 par value:

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership[1]	Percent of Class
Davis Selected Advisers, L.P. 2949 East Elvira Road, Suite 101 Tucson, Arizona 85706	80,032,687[2]	11.8%
Peter B. Lewis 6300 Wilson Mills Road Mayfield Village, Ohio 44143	49,279,799[3]	7.3%

1 Except as otherwise indicated, the persons listed as beneficial owners of the common shares have sole voting and investment power with respect to those shares. Certain of the information contained in this table, including related footnotes, is based on the Schedule 13G filings made by the beneficial owners identified herein.

2 The common shares are held in investment accounts maintained with Davis Selected Advisers, L.P., as of December 31, 2008, and it disclaims any beneficial interest in such shares. Davis Selected Advisers, L.P. has advised that it has sole voting power as to 74,529,201 of these shares, no voting power as to the balance of these shares, and sole investment power as to all of these shares. Mr. Charles A. Davis, a director of Progressive, has no affiliation with Davis Selected Advisers, L.P.

3 Includes 221,756 shares held for Mr. Lewis by a trustee under Progressive s 401(k) Plan, 428,544 common shares subject to currently exercisable stock options, and 12,549 restricted common shares granted to Mr. Lewis in his capacity as Chairman of the Board. Also includes 827,885 shares held by two charitable entities which Mr. Lewis controls, but as to which he has no pecuniary interest, and 454,000 shares held by four trusts for family members, as to which Mr. Lewis is a trustee but has no pecuniary interest.

Security Ownership of Management

The following information summarizes the beneficial ownership of Progressive s common shares as of December 31, 2008, by each director and nominee for election as a director of Progressive, each of the named executive officers (as identified on page 35) and by all directors and all individuals who were our executive officers on December 31, 2008, as a group. In addition, to provide a more complete picture of certain individual s financial interest in Progressive shares, the final two columns include share equivalent units held in our benefit plans that do not technically qualify as beneficially owned under the applicable regulations, also as of December 31, 2008.

Name	Common Shares Subject to Restricted Stock Awards[1]	Beneficially Owned Common Shares Subject to Currently Exercisable Options[2]	Common Share Equivalent Units[3]	Other Common Shares Beneficially Owned[4]	Total Common Shares Beneficially Owned	Percent of Class[5]	Units Equiva-lent to Common Shares[6]	Total Interest in Common Shares and Unit Equivalents
William M. Cody	154,210	110,140	50,920	16,049	331,319		0	331,319
Charles A. Davis	9,761	82,337	19,022	152,033	263,153	*	10,377	273,530
Brian C. Domeck	99,548	96,992	0	8,054	204,594	*	0	204,594
Roger N. Farah	7,212	0	0	7,500	14,712	*	0	14,712
Susan Patricia Griffith	146,839	54,772	0	45,854	247,465	*	0	247,465
Stephen R. Hardis	11,225	82,337	6,817	179,163	279,542	*	158,366	437,908
Bernadine P. Healy, M.D.	9,203	0	0	51,235	60,438	*	4,043	64,481
Charles E. Jarrett	166,432	289,938	56,130	4,100	516,600	*	5,396	521,996
Jeffrey D. Kelly	9,203	30,448	13,095	50,820	103,566	*	15,347	118,913
Abby F. Kohnstamm	9,203	0	11,553	0	20,756	*	0	20,756
Peter B. Lewis	12,549	428,544	0	48,838,706[7]	49,279,799	7.3%	0	49,279,799
Norman S. Matthews	9,761	30,448	23,980	188,212	252,401	*	0	252,401
Patrick H. Nettles, Ph.D.	9,203	0	18,176	0	27,379	*	0	27,379
Glenn M. Renwick	1,628,903	1,962,537	545,829	925,420	5,062,689	*	55,428	5,118,117
John P. Sauerland	100,320	124,390	0	46,280	270,990	*	0	270,990
Donald B. Shackelford	8,924	47,292	14,410	802,245	872,871	*	22,804	895,675
Bradley T. Sheares, Ph.D.	9,176	0	4,585	0	13,761	*	18,336	32,097
Raymond M. Voelker	144,896	0	0	36,915	181,811	*	0	181,811
All 23 Executive Officers and Directors as a Group	2,764,215	3,430,483	782,315	51,557,956	58,534,969	8.6%	292,109	58,827,078

* Less than 1% of Progressive s outstanding common shares.

[1] Includes common shares held for executive officers and directors pursuant to unvested restricted stock awards issued under various incentive plans we maintain. The beneficial owner has sole voting power and no investment power with respect to these shares during the restriction period.

[2] The beneficial owner has no voting power or investment power with respect to these shares prior to exercising the options.

[3] These units have been credited to the individual s account under certain of our deferred compensation plans and are included in shares beneficially owned due to the plan features described below. Each unit is equal in value to one Progressive common share.

For non-employee directors, the number represents units that have been credited to his or her account under The Progressive Corporation Directors Restricted Stock Deferral Plan, as amended and restated (the Directors Restricted Stock Deferral Plan), under which each director has the right to defer restricted stock awards. Distributions from the Directors Restricted Stock Deferral Plan will be made in Progressive common shares at the expiration of the deferral period under the plan. Upon the termination of a director s service as a director, the plan provides that certain shares would be distributed to the director promptly thereafter. As to the number of shares that would be so distributed upon a director s termination of service, the director is considered to have investment power over those shares (although not voting power), and those shares are deemed beneficially owned. See page 49 for a description of the Directors Restricted Stock Deferral Plan.

For executive officers, the number represents units that have been credited to the participant s account under The Progressive Corporation Executive Deferred Compensation Plan, as amended and restated (the EDCP), upon the deferral of cash bonus awards and restricted stock awards. As to these units, the participant has sole investment power but no voting power. In this case, the participant has investment power due to his or her ability to instruct the plan trustee to liquidate his or her deemed investment in Progressive stock and re-allocate those amounts into one of the other deemed investments that are available under the plan. See a description of the EDCP beginning on page 42.

[4] Includes, among other shares, common shares held for executive officers or, in certain cases, their spouses who are former employees, under The Progressive Retirement Security Program. Unless otherwise indicated below, beneficial ownership of the common shares reported in the table includes both sole voting power and sole investment power, or voting power and investment power that is shared with the spouse and/or minor children of the director or executive officer.

[5] Percentage based solely on Total Common Shares Beneficially Owned.

[6] The units disclosed are in addition to common shares beneficially owned and have been credited to the individual s account under one or more of our deferred compensation plans, as discussed below. Each unit is equal in value to one Progressive common share.

For non-employee directors, the number represents units that have been credited under The Progressive Corporation Directors Deferral Plan, as amended and restated (Directors Deferral Plan) and certain amounts credited under the Directors Restricted Stock Deferral Plan. Each of our directors who is not an employee of Progressive (other than Mr. Peter B. Lewis) and was a director prior to April 2006, participates in the Directors Deferral Plan, under which cash retainer and meeting fees were deferred. The amounts deferred under the Directors Deferral Plan are deemed invested in Progressive shares for the entire deferral period, and distributions from the plan will be made only in cash at the time selected by the participant or as otherwise required by the plan. As such, the investor has neither investment power or voting power over those units. See page 49 for a description of the Directors Deferral Plan. Deferrals of restricted stock under the Directors Restricted Stock Deferral Plan are included in this column to the extent that Progressive common shares would not be distributed promptly after the termination of the director s service, in which case the director is also not considered to have investment power or voting power over those shares (for example, distributions that would be made in future years under an installment distribution plan selected by the director in accordance with the plan); and

For executive officers, the number represents units that have been credited to the executive officer under the EDCP upon the deferral of restricted shares that were awarded in or after March 2005. These deferral amounts are deemed to be invested in Progressive shares during the entire deferral, and no other deemed investments are available to the participant. In addition, the distribution of Progressive common shares to the executive under the EDCP would not be made until six months after the termination of his or her employment. As a result, the executive has neither investment power or voting power during the deferral period.

[7] See Footnote 3 on page 18.

Section 16(a) Beneficial Ownership Reporting Compliance.

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our officers and directors, and persons who beneficially own more than 10% of our common shares, if any, to file reports of ownership and changes in ownership of Progressive stock with the Securities and Exchange Commission. Based on our review of Section 16 reports prepared by or furnished to Progressive and representations made by our officers and directors, we believe that all filing requirements were met on a timely basis during 2008. However, on November 26, 2008, Peter B. Lewis filed a Form 4 that reported, in part, (i) a series of six transactions (two acquisitions of shares and four dispositions) from February 1993 through July 2002 by a trust that holds Progressive shares for the benefit of Mr. Lewis s grandchildren, and (ii) that the trust currently holds 400,000 Progressive common shares. Mr. Lewis, who has been a trustee of the trust since at least February 1993 but has no financial interest in the trust, inadvertently had omitted these holdings and transactions from his prior filings.

COMPENSATION DISCUSSION AND ANALYSIS

Our compensation program for executives, including the named executive officers identified in the Summary Compensation Table on page 35, is designed and implemented under the direction and guidance of the Compensation Committee of the Board of Directors. Broadly stated, we seek to maintain a consistent compensation program with the following objectives:

- Attract and retain outstanding executives with the leadership skills and expertise necessary to drive results and build long-term shareholder value;
- Motivate executives to achieve the strategic goals of Progressive and their assigned business units;
- Reward and differentiate executive performance based on the achievement of challenging performance goals; and
- Align the interests of our executives with those of shareholders.

EXECUTIVE COMPENSATION PROCEDURES AND POLICIES

Executive Compensation in General

The main components of our executive compensation program are base salaries, opportunity for an annual cash bonus, and longer term incentives in the form of restricted stock awards made on an annual basis. Base salaries are generally intended to be competitive with those offered for similar jobs at comparable companies, with variations determined by individual factors. Annual cash bonus potential (under a program that we refer to as Gainsharing) is tied to the actual performance of the company s operating businesses or the executive s assigned business unit. Restricted stock is granted in the form of time-based awards and performance-based awards. The combination of Gainsharing bonuses and restricted stock awards provide variable compensation that reflect the company s performance and our stock price.

At senior executive levels, variable compensation accounts for a very significant portion of total potential compensation, providing tangible incentives to executives to drive business performance. For each of our named executive officers (other than our Chief Executive Officer), 80% of his or her maximum compensation for 2008 was comprised of cash bonus potential and restricted stock awards; for the CEO, such variable compensation accounted for over 90% of his potential earnings for the year. As a result, total pay for our executives is heavily weighted in favor of performance-based compensation that is tied directly to our strategic goals or to the performance of our common shares, thus aligning executives interests with those of shareholders.

Other types of compensation available to executives include health and welfare benefits, deferred compensation arrangements, severance payments, and very limited perquisites, and are discussed in more detail below.

Compensation Committee Decisions

The Compensation Committee makes all final determinations regarding executive compensation, including salary, equity (restricted stock awards) and nonequity incentive compensation (Gainsharing) targets, and related performance goals. In addition, the Committee monitors and determines the benefits that may be paid to an executive upon his or her leaving the company or upon a change in control of the company to ensure that such payments are made under appropriate circumstances and in appropriate, market-based amounts. The Compensation Committee met six times in 2008 and discussed executive compensation at each of those meetings.

Committee decisions on executive compensation are made after considering each executive s role and responsibilities, performance evaluations, recommendations presented by management, compensation data from comparable companies obtained by Progressive from independent third parties and analyses performed by the company s Compensation Department. The Compensation Department consults with the company s Chief Executive Officer on significant issues regarding employee compensation, including programs and issues relating to executive officers. Our CEO also participates in certain Committee meetings (two times in 2008) to discuss significant compensation issues with the Committee or to provide recommendations to the Committee regarding the compensation of executive officers. The Committee s executive compensation decisions thus represent the culmination of extensive analysis and discussion, which typically take place over the course of multiple meetings between the Committee and management, including our CEO, our Chief Human Resource Officer, members of the Compensation Department and Law Departments, and other Progressive personnel. In addition, the Committee routinely reports to the full Board of Directors on executive compensation matters, generally after each regularly scheduled Committee meeting.

The Committee delegates to management the day-to-day implementation of compensation programs for employees below the level of executive management, subject to the terms of plans approved by the Committee. Generally, however, we seek to operate a consistent compensation program across our company, and as a result, determinations made by the Committee on executive compensation generally apply to other employees, as well. For example, the performance criteria applied to determine the annual cash bonuses for most executives under our Gainsharing program (discussed in more detail below) also are used to determine bonuses for substantially all of our other employees. In this way, employees as a whole are focused on the same set of strategic priorities.

The Committee has the authority under its Charter to hire its own compensation consultants, at Progressive s expense. In recent years, the Committee determined that retaining a consultant was not necessary in view of Progressive s consistent compensation program, and the availability of comparable market data from independent third parties, among other factors. In 2008 and early 2009, the Committee again reviewed its needs and considered the potential benefits of retaining a consultant, but took no action to retain one at that time. The Committee will continue to assess its needs at least annually and may elect to hire a consultant in the future to review aspects of the company s executive compensation arrangements.

During 2008, our Compensation staff consulted with Pearl Meyer, an executive compensation consulting firm, on a limited basis regarding the structure of our performance-based compensation program for our employees, including executives, and potential alternatives. Total fees paid to the consultant amounted to approximately $22,000 during the year. These consultations contributed to our thinking about performance-based compensation arrangements and were considered in formulating changes to our executive compensation program for 2009, which are described in more detail below.

Compensation Comparisons

Our executive compensation program is market-based and is designed to be competitive with other compensation opportunities available to executives. However, compensation comparisons do not typically drive the Committee s decisions, which result from a number of factors that are reviewed and evaluated by the Committee. These factors can be different for different individuals, can vary from year to year, and can include a number of qualitative and quantitative judgments, including the nature of a specific executive s position and responsibilities, our business needs and culture, the tenure of an executive in his or her current position, past compensation history, individual performance, and the executive s future potential, among other matters. Compensation comparisons are another factor that enter into this analysis, which may in an individual case become more important, for example, if the executive s pay is substantially below or above the identified median levels.

We identify comparable companies from many industries in a revenue range that is comparable to our annual revenues, as indicated on compensation surveys that we obtain from independent third party vendors. Comparable companies are not limited to those in the insurance industry. This choice reflects: that there are a limited number of publicly held insurers that focus exclusively, or even primarily, on automobile insurance (and none with comparable revenue or market value characteristics); that we do not generally recruit senior management level talent from other insurance companies; and that our executives have employment opportunities with companies doing business in a variety of industries. As a result, we view the broader range of companies to be a better reflection of the marketplace for the services of our executives. We do not focus on the identity of any individual company, but are interested in the aggregate data and the percentile breakdowns, which are used as a guide (among other factors) in our executive compensation decisions. Similar comparisons and evaluations are performed with respect to employees at all levels of the company.

Data regarding comparable functions at other companies and the applicable ranges and types of compensation are collected by our Compensation Department and presented to the Committee for consideration prior to the time that annual compensation decisions are being considered. One of the difficulties with compensation comparisons can be, for certain executive roles, the inability to determine reliably a comparison group for the executive. If direct job comparisons are not available for an executive, we seek to match the executive with job classifications from comparable companies that most closely resemble the executive s position and responsibilities.

For the 2008 compensation decisions, the comparison group for the CEO consisted of 67 public companies with annual revenues from $10 billion to $20 billion, as identified in compensation surveys purchased by the company from Towers Perrin. Given our 2007 revenue of approximately $14.7 billion, we believe that this range provided appropriate data for comparison purposes. The 2008 comparisons for our other named executive officers were taken from compensation surveys produced by Towers Perrin, Mercer Consulting, and McLagan Partners, although the number of companies and revenue ranges varied from position to position based on the type of position, availability of comparison matches, and other factors. All compensation comparisons referred to in the discussions below are based on this data, which were provided to the Committee in early 2008.

Internal Pay Equity; Wealth Accumulation

We do not use internal pay equity or wealth accumulation analyses to limit compensation paid to the Chief Executive Officer or other executives. Such systems typically put a ceiling on part or all of an executive s compensation based on considerations such as the amount of compensation paid to another executive or employee or the value of awards previously made to the executive in question. Management and the Committee do not believe that such arbitrary limitations are an appropriate way to make compensation decisions for our executives and that such procedures would be contrary to the interests of the company and our shareholders. Instead, our focus is to make appropriate executive compensation decisions annually, so that executives are paid at competitive levels with a significant at risk, performance-based component that is commensurate with the executive s increasing responsibilities. We rely on the judgment of the Committee, after considering recommendations from management, including the CEO, available market data and evaluations of executive performance, in making these decisions.

Use of Tally Sheets

When the Compensation Committee is considering annual compensation decisions for executives, the Committee is provided with information showing, for each executive, the total aggregate compensation (salary, cash bonus potential, and restricted stock award values) to be awarded to such executive for the upcoming year. These so-called tally sheets are used by the Committee to review each executive s current compensation level and to enable meaningful comparisons to the compensation paid to similar executives at comparable companies. In this way, the Committee monitors the reasonableness of its annual compensation decisions for each executive.

In addition, at least annually, the Committee receives tally sheets summarizing the payments that would be made to each executive upon the occurrence of various scenarios, such as termination, retirement, or a change in control. These tally sheets allow the Committee to see, in one place, all of the potential payouts that an executive can receive in addition to annual compensation awards. Such payouts may arise from a number of sources, depending on the scenario triggering the payments, including: the executive s prior service and earnings (such as distributions from deferral accounts); payments triggered by an employment termination (severance); or an acceleration of a right that otherwise would not have occurred, if at all, until a future date (for example, vesting of restricted stock awards upon a qualifying retirement or a change in control). The Committee is thus able to understand and monitor the amount of such potential payouts in each scenario, and to distinguish the source of individual components of such payouts.

To the extent that these payments arise from an executive s prior earnings (such as distributions from deferral accounts), the Committee generally does not view such payments negatively, since those amounts were previously earned in full by the executive, the value of the account has increased (or decreased) over time based on the executive s investment elections (which can include investments in Progressive s stock), and we have made no subsequent contributions to increase the value of these accounts. Potential severance payments and acceleration events, on the other hand, are monitored by the Committee to ensure that they are reasonable and appropriate in the applicable scenarios. The Committee will continue to assess these programs in the future as new information develops. We describe each of these elements of our compensation program in more detail below and under Potential Payments upon Termination or Change in Control beginning on page 44.

No Tax Gross-Up Payments

We do not provide, and no executive officer is entitled to receive, any tax gross-up payments in connection with compensation, severance, perquisites, or other benefits provided by Progressive. There is one minor exception to this rule that is applicable to all of our regular employees: we pay employees 5-year anniversary awards (i.e., at their 5th, 10th, 15th, etc., anniversaries) in amounts not to exceed $600 on a net (after tax) basis. When such an award is paid to a named executive officer, the gross (pretax) amount is included in All Other Compensation on our Summary Compensation Table.

Effect of Any Future Financial Restatement; Recoupment

Cash bonuses paid to our senior executives from and after 2007, and performance-based equity awards granted to executive officers from and after March 2008, are subject to recoupment by us if the applicable operating or financial results triggering such payment or the vesting of such award are later restated. For additional information concerning these recoupment rights, see Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table beginning on page 37.

Stock Ownership Guidelines for Executives

Within five years after becoming our CEO and at all times while serving as CEO thereafter, the CEO must acquire and hold Progressive stock (or equivalent vested interests, such as shares held on his behalf in our 401(k) or equivalent units held in our executive deferred compensation plan, but excluding unexercised stock options and unvested restricted stock) with a minimum value of five times the CEO s base salary. Executive officers who report directly to the CEO are expected to hold meaningful amounts of Progressive stock at levels that their respective compensation and financial circumstances permit. To support this goal, each executive s annual compensation is heavily weighted towards equity compensation. As a result, within three years of becoming an executive, each executive is expected to hold restricted or unrestricted stock with a value of at least three times his or her base salary. Management and the Committee believe that stock holdings under these guidelines, as well as additional, voluntary holdings by executives in our stock option, 401(k) and deferral plans or in personal accounts, appropriately ensure that the interests of management will be aligned with those of our long-term shareholders. As of December 31, 2008, each of the named executive officer s holdings of Progressive stock satisfied the applicable guideline.

ELEMENTS OF COMPENSATION ANNUAL DECISIONS OR AWARDS

Our executive compensation program has retained the same basic format for more than a decade. We have three primary compensation elements, each of which involves annual decisions made by the Compensation Committee to ensure reasonable, competitive pay for our executives, with a balance of fixed and variable compensation. These elements are:

- Base salaries;
- Annual cash bonus potential under our Gainsharing program; and
- Equity-based compensation in the form of both time-based and performance-based restricted stock.

Each compensation element will be discussed in turn, along with information concerning the 2008 decisions made by the Committee and, where applicable, 2008 performance results.

Salaries

Executive salaries, which are set by the Compensation Committee each year, are designed to attract and retain executive talent and to reward individual performance. As a general matter, executive salaries are intended to be competitive with amounts paid to executives who have similar responsibilities at comparable companies, with the potential for above average total compensation being provided by the variable compensation elements discussed below. Variations from comparison averages can occur for a number of reasons, including the nature of a specific executive s position and responsibilities, our business needs and culture, the tenure of an executive in his or her current position, individual performance and the executive s future potential.

For Messrs. Cody, Jarrett, Sauerland, and Voelker and Mrs. Griffith, their 2008 salaries reflected increases of between 3.8% and 4.3% when compared with the end of the prior year. Each of these increases was in line with the market-based increases for our employees as a whole and for the executive s respective comparison group. In March 2008, Mrs. Griffith was promoted to the President of our Claims Group and received another increase of about 4%, reflecting the significant increase in responsibility entailed by this new position. Mr. Domeck, who at the beginning of 2008 was starting his second year as our CFO, received a salary increase of about 18.8% as a step toward closing the gap between his salary and the median salaries for CFO s at comparable companies. In each case, the salary increases further evidenced continuing satisfactory performance and contribution to the executive team.

Although, as explained above, comparison data is only one of a number of factors that enter into the Committee s decisions each year, such comparisons may be useful to shareholders as a reference point. The following discussion is based on data provided by our HR Compensation group to the Committee in early 2008 showing salary data for each executive s comparable position. For 2008, the salary for Mr. Voelker, our Chief Information Officer, was slightly above the median for comparable positions, which reflects in part his long tenure in that position and the continuing importance of technology to our business operations, while Messrs. Domeck, Jarrett, and Sauerland and Mrs. Griffith were below median levels for their respective comparison groups. The salary for Mr. Cody, our Chief Investment Officer, exceeded the median for his comparison group, reflecting not only his long tenure but also that, under our pay structure, Mr. Cody s potential variable compensation is generally below the amounts that can be earned by investment managers at other companies.

As to our CEO, Glenn Renwick, since February 2002, his annual salary has remained at $750,000 per year, well below the median for chief executives at comparable companies. We discuss Mr. Renwick s 2008 compensation on page 28.

Shareholders should also note that the actual amounts paid in salary to the named executive officers (as disclosed below in the Summary Compensation Table) in 2008 were higher than their respective annual salary figures. This is because we issued 27 paychecks to all salaried employees in 2008 versus 26 paychecks in most years. Such a 27-paycheck year is a situation that arises in bi-weekly payroll systems, such as ours, about every 10 or 11 years. In 2009, we will return to the typical 26 paycheck year, under which the amount actually paid is often slightly below the annualized salary figure, because we typically implement raises in February of the year.

Cash Bonuses

Gainsharing Program. Each of the named executive officers had the opportunity in 2008 to earn an annual, performance-based cash bonus under our Gainsharing program. Executive bonuses are determined using the same performance criteria that determine the Gainsharing bonuses that are paid to all of our other executives and our non-executive employees, resulting in a consistent set of goals across our entire insurance operation. Gainsharing bonuses are determined using the following formula:

Paid		Target		Performance		Annual
Salary	X	Percentage	X	Factor	=	Bonus

For each executive, his or her salary and bonus target percentage are established by the Committee each year during the first calendar quarter. When the participant s paid salary is multiplied by his or her assigned target percentage, the product is referred to as the participant s target bonus or target bonus amount for the year. The performance factor can range from 0.0 to 2.0 each year, depending on the extent to which actual performance results for the year fall short of, meet, or exceed the objective performance goals established by the Committee in the first quarter of the year.

As a result, each participant can earn an annual Gainsharing bonus of between 0.0 and 2.0 times his or her target bonus amount (with an amount equal to 2.0 times an executive s target bonus thus being the executive s maximum potential bonus). The payment of the target bonus amount would result from a 1.0 performance factor under the plan. For 2008, the performance factor for each of the named executive officers, other than Mr. Cody, was determined by the performance of our principal insurance businesses (referred to as our Core Business). Mr. Cody s factor was determined by the performance of our fixed-income investment portfolio and is discussed in more detail below. All Gainsharing and other performance-based cash bonus awards for the named executive officers are reported on the Summary Compensation Table below as Non-Equity Incentive Plan Compensation.

The performance standards applicable to the Gainsharing program are established by the Committee each year in the first quarter and are not thereafter modified. The performance factor for our Core Business is then calculated on a monthly basis, using year-to-date results, and published in our regular, monthly earnings release. In addition, it should be noted that our Gainsharing performance factor is used, among other factors, to calculate the dividend that may be paid to shareholders each year under our variable dividend policy. In this way, the Core Business results also can translate into a benefit to shareholders, although due to the extent of our investment losses in 2008, no dividend was paid for the year, in accordance with terms of the dividend policy.

Gainsharing is designed to reward executives based on the operating performance of Progressive s insurance business as a whole and/or an executive s assigned business unit, as compared with objective performance criteria as established by the Committee. The purpose of the cash bonus program is to motivate executives to achieve and surpass current strategic performance goals, which over time, should positively impact the returns of long-term shareholders.

It should be noted that under this program, all of our executives (other than Mr. Cody, our Chief Investment Officer) and all but a small number of our employees who work in our investment operations, earn their annual cash bonus based solely on the operating results of our Core Business, which includes only our insurance operations. As a result, the returns from our investments, in both good and bad years, do not affect the bonuses that are paid to virtually all of our employees, including the named executive officers (other than Mr. Cody and our investment staff). The Committee and management believe that this result is appropriate since the day-to-day work of the executives and employees outside of the investment group does not impact the investment returns, and the Gainsharing program thus serves to focus these employees on our insurance operations where they can have an impact. However, the difficult investment climate and our poor investment results in 2008 have led the Committee to reconsider this practice as it applies to the CEO and the CFO, as discussed below under Changes for 2009.

Historical Gainsharing Experience. Outstanding growth and profitability results in each of 2003 and 2004 were rewarded by a Core Business performance factor of 2.0, and the highest possible bonus under our Gainsharing plans, for most executive officers and other employees of Progressive. A significant down year in our insurance operations in 2000, however, resulted in a performance factor of 0.0 for our Core Business, and no annual cash bonus, for most executive officers and employees. Performance factors for the Core Business in 2006, 2007 and 2008 were 1.18, .74, and .80, respectively, reflecting strong (although generally decreasing) underwriting profitability, but lagging growth compared to our pre-established targets. Throughout the 15-year history of our company-wide Gainsharing program (including 2008), the performance factor for the Core Business has averaged about 1.31. These results confirm that our Gainsharing plans operate not only to reward excellent performance, but also to withhold or temper cash bonuses if our actual performance results fail to achieve pre-defined goals.

2008 Gainsharing Bonuses Core Business. Gainsharing target percentages for the named executive officers were determined by the Compensation Committee. Consistent with how our program has operated in recent years, Mr. Renwick s target percentage was set at 150%, while each of the other named executive officers had his or her target set at 100%.

The 2008 performance factors for each of the named executive officers (other than Mr. Cody, whose bonus calculation is discussed in the next section) were determined using Gainsharing standards approved by the Compensation Committee for our Core Business, which was defined to include our Agency Auto, Direct Auto, Special Lines, and Commercial Auto business units. We seek to offer an appropriate rate to every auto risk and are focused on growing our customer base both by attracting new customers and by earning the loyalty of existing customers so that we may retain their business. Thus, for 2008, we used the number of policies in force to measure growth for each of our businesses, to better align our Gainsharing program with our companywide strategic goal of growing policies in force as fast as possible at a 96 combined ratio or better. This strategic goal, which is applicable to virtually all employees through the Gainsharing plan, allows employees to observe and understand how their day-to-day efforts to bring new customers on board and retain existing customers (i.e., increase policies in force) can translate into Gainsharing gains and enhance company performance.

In addition, in evaluating the businesses that comprise the Core Business, management monitors and analyzes both the level of new policy acquisition during the year and the rate of renewal on policies written in prior years to better understand each business unit s overall growth. As a result, in 2008, we adopted two Gainsharing matrices for each business unit, one that focused on the new business component and one that focused on the renewal business component of the business unit, so that the growth and profitability results could be tracked separately for each of these components and then combined to provide a performance score for the overall business unit. In this way, the 2008 plan, and the performance that it was intended to reward, were aligned with management s approach to the business.

Each Gainsharing matrix assigns a specific score between 0.0 and 2.0 for different combinations of potential growth and profitability outcomes for the year. As such, a performance score at or near a 1.0 can be achieved under each matrix with a variety of growth/profitability combinations (i.e., if growth slows, a 1.0 may still be achieved if profitability increases and, likewise, a moderate decrease in profitability may be offset by higher growth levels to generate a 1.0 score). Under the standards approved by the Committee for 2008, assuming that we could achieve profitability levels at or better than our companywide goal of a 96 combined ratio or better (an assumption that was reasonable at the beginning of 2008 and is consistent with our recent performance), a Gainshare performance factor of 1.0 for the Core Business as a whole would have required the company to achieve growth (new or renewal) levels in one or more of our main business units that exceeded our internal expectations for the year.

Our internal expectations are developed by management from projections for individual markets and segments in each business unit and, as such, reflect the management s best estimate for the upcoming year, taking into account each business s planned initiatives, the competitive environment and other market factors. In this context, the 2008 performance goals were explicitly designed by management and the Committee to motivate and reward strong growth in our operating units, while maintaining our underwriting discipline a result that was expected to be difficult to achieve at a time when the company s 2007 performance, conditions in the insurance industry and, more generally, conditions in the economy, made the prospects for such growth uncertain. The next paragraphs discuss our actual performance results for the year.

For all of our named executive officers (other than Mr. Cody), as well as substantially all of our other employees, 2008 bonuses were determined solely by the performance of our Core Business. This Gainsharing calculation resulted in a performance factor of .80 (out of a possible 2.0). The following table presents the overall 2008 growth and profitability data for the businesses that comprised our Core Business. The growth figures in the table below were determined by the percentage change in policies in force at year-end 2008, as compared with the 2007 year-end policy count for that business unit. Profitability was determined by the underwriting performance of the business unit, as measured by the applicable GAAP combined ratio.

Business	GAAP Combined Ratio[1]	Increase (Decrease) in Policies in Force
Agency Auto	95.1	(2)%[2]
Direct Auto	93.9	9%[2]
Special Lines		7%

Commercial Auto	94.7	0%

[1] Consistent with the presentation of the combined ratio of our Personal Lines segment in our public reports, the combined ratio results for our Special Lines business are not presented separately and, instead, are included in either the Agency or Direct results in the table above, depending on whether the underlying policy is written through agents/brokers or directly by Progressive.

[2] Includes only Auto policies in force.

From actual performance results for the year, we determined the performance score for each business unit comprising the Core Business, weighted those scores based on each business unit s relative contribution to overall net premiums earned, and then added the weighted scores to determine the performance factor for the Core Business, as follows:

Business	Weighted Performance Score
Agency Auto	.39
Direct Auto	.37
Special Lines	.04
Commercial Auto	.00
Performance Factor	.80

See Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table, beginning on page 37, for a more detailed discussion of the Gainsharing matrices and the calculation of performance scores.

As can be seen, our performance in 2008 resulted in a performance factor for our Core Business of .80 out of a possible 2.0. The profitability of our insurance operations remained strong for the year, albeit with increasing combined ratios compared to the prior year. In addition, we achieved relatively strong growth in the Direct Auto business and increased retention rates in both the Direct Auto and Agency Auto businesses for the year. However, new business growth rates lagged the objective goals that would have resulted in a target score of 1.0, as established in early 2008, in our Agency Auto and Commercial Auto businesses, which faced a challenging operating and economic environment during the year. As a consequence, and for the second straight year, our performance failed to achieve combinations of growth and profitability in our main business units that would produce a target 1.0 score for the Core Business as a whole. Most Progressive employees, including the named executive officers (other than Mr. Cody), thus earned a cash bonus equal to approximately 80% of their target bonus amount.

2008 Bonus Investment Performance. For William Cody, the head of our investment operations, his performance factor was determined by the performance of our fixed-income investment portfolio on a total-return basis when compared, on a risk-adjusted basis, with a defined benchmark of 125 comparable money management firms. The firms comprising the benchmark managed similar fixed-income portfolios in 2008, as determined by Rogers Casey, the independent third party vendor that collects the information on the benchmark firms. The vendor further collects and provides to us the appropriate total return performance data for the benchmark firms, and this data forms the basis for the calculation of the ranking of our fixed-income portfolio against the benchmark firms. Our equity portfolio is not included in this analysis because this portfolio tracks the Russell 1000 Index and is not actively managed by Mr. Cody s group.

Under this calculation, a performance score of approximately 1.0 would result (and Mr. Cody would earn a bonus of equal to the score times his target bonus amount), if his group s investment performance ranked at the 50th percentile of the benchmark money management firms. A maximum score of 2.0 would be earned if performance exceeded the 95th percentile of the benchmark firms, while a minimum score of 0.0 would result if performance was below the 5th percentile. For 2008, the results of our fixed-income portfolio ranked near the bottom 5% when compared with the results of the money management firms included in the benchmark. As a result, for 2008, Mr. Cody was entitled to a cash bonus in the amount of $19,644, based on a performance score of 0.05, but he declined to accept it due to the significant losses in our fixed-income portfolio for the year.

Equity Awards

Restricted Stock Program. Our executive compensation program includes long-term incentives through an annual grant of restricted stock awards. Under a restricted stock grant, the executive receives an award of Progressive s common shares, subject to restrictions on vesting and transferability. Annual awards of restricted stock to executive officers are intended to tie the amount of compensation ultimately earned by the executive to our long-term performance and the market value of our common shares.

Each named executive officer receives a restricted stock award on an annual basis. All executive officers receive a time-based restricted stock award that will vest over future time periods, most often in three equal installments in the third, fourth, and fifth years after the grant. The value of these awards is based on a percentage of the individual s salary at the time of the award, which is determined by the Committee on an annual basis. Time-based restricted stock awards align the interests of executives with our shareholders and serve as a strong retention device, encouraging our senior executives to stay with Progressive until future vesting dates occur.

In addition, our CEO and the executive officers who report directly to him (along with a small group of other senior employees) each receives an annual award of performance-based restricted stock. The number of shares granted to each executive, and the objective performance criteria that govern if and when the performance shares will vest, are approved each year by the Committee at the time the awards are granted and are not thereafter modified. These performance criteria are established with management s input, based on then-current market conditions and our long-term strategic goals. If the applicable performance conditions are not satisfied within the time frame established by the Committee (typically, 10 years), the awards will be forfeited by the executives. Performance-based awards operate as an incentive for executives to achieve long-term business objectives, thus further aligning the interests of shareholders and our executives, while also supporting retention of critical employees. In addition, these awards increase the at risk nature of our executives compensation.

Timing of Awards. We expect that, consistent with our actions in recent years, annual restricted stock awards will be made in March of each year, unless a legal or plan requirement causes us to adopt a change for a specific year. March is considered appropriate for such awards because it follows shortly after annual performance evaluations and salary adjustments for executives and other equity eligible employees, thus providing an administratively convenient time to calculate the awards and communicate them to the recipients. Historically, interim awards have been made to executive officers only at the time of his or her appointment to or promotion within the executive team; any such interim award to an executive officer would require the approval of the Compensation Committee.

Qualified Retirement Rights. Executive officers, along with other equity award recipients, are eligible for qualified retirement treatment (sometimes referred to as the Rule of 70) under our equity compensation plans. Under this arrangement, executives who leave their employment with Progressive after age 55 with certain years-of-service requirements, either retain a portion of their outstanding equity awards or have a portion of those outstanding awards vest immediately upon termination. The Rule of 70 provisions are intended to provide a limited benefit for long-tenured employees who retire from Progressive after satisfying the age and service requirements. None of our named executive officers currently satisfies the age and years-of-service requirements to be eligible for qualified retirement treatment. Mr. Renwick, our CEO, will qualify for such treatment in May 2010. For more information about the Rule of 70 benefits, see Potential Payments Upon Termination or Change in Control beginning on page 44.

2008 Restricted Stock Awards. In 2008, two forms of restricted stock awards were granted to executive officers and certain other senior level employees. Time-based restricted stock awards were granted to all named executive officers and 767 other senior level employees; recipients of time-based awards comprise approximately 3% of our entire employee population. The time-based restricted stock awards will vest in three equal annual installments, on January 1 of 2011, 2012 and 2013, subject to the vesting and forfeiture provisions in the applicable plan and grant agreement. In addition, the named executive officers and 34 other senior managers received performance-based restricted stock grants, with the vesting date tied to the achievement of specific business results that are defined by our long-term growth and profitability objectives.

CEO Glenn Renwick received a time-based restricted stock award with a value equal to 500% of his salary and a performance-based restricted stock award equal in value to 500% of his salary. Mr. Renwick s equity award was proportionally larger than other executives awards due to the level of responsibilities inherent in the CEO position and to the substantially below-market level of his base salary. As a result, more of his compensation is at risk and dependent on our operating performance and stock price over the next several years.

The other named executive officers received time-based awards in 2008 with a value equal to 100% of their respective salaries, and performance-based awards with a value of 100% of salary, other than Mr. Cody who received a performance-based award with a value of 110% of salary. Performance-based awards to named executive officers other than the CEO would typically range from 75% to 125% of salary each year, and all 2008 awards were within this range. The amount of the restricted stock awards may vary from year to year based on individual factors and the company s business needs. The Committee, after considering the recommendations of and discussions with the CEO and the Chief Human Resource Officer, determines the value of each executive s performance-based award based on factors such as past performance, skills and competencies and expected future contributions. For 2008, the aggregate dollar value (fair value on the date of grant) of equity awards made to the seven named executive officers was approximately $6,045,000 in time-based awards and $6,068,000 in performance-based awards.

Performance-based restricted stock awarded in 2008 will vest only if our insurance subsidiaries generate net premiums earned of $16.5 billion or more over a period of twelve (12) consecutive months while maintaining an average combined ratio of 96 or less over the same period. If we do not satisfy these criteria prior to December 31, 2017, the performance shares will be forfeited. While the profitability target of this standard is within our recent performance experience, the growth target is aggressive. Our net premiums earned for 2008 were approximately $13.6 billion, and the $16.5 billion target thus represents about a 21% increase from that level. It should be noted, however, that as of year-end 2007, shortly before these decisions were made, we had a *decrease* in year-over-year growth of net premiums earned of approximately 1.7%, and our net premiums earned again *decreased* by approximately 1.8% in 2008 as compared with 2007. Accordingly, to reach net premiums earned of $16.5

billion by year end 2012 (a five year period from the date of the original award), we must now average annual growth of about 4.9% for 2009-2012. In view of these recent growth levels, therefore, we view this performance target as aggressive.

Comments Regarding 2008 Compensation Decisions

Chief Executive Officer. In the case of Glenn Renwick, our CEO, his salary level has been maintained at $750,000 since February 2002, well below the 50th percentile of $1,222,000 for CEO salaries at comparable companies. Mr. Renwick s cash bonus (Gainsharing) potential has also remained at the same level since February 2002. The Compensation Committee determined in 2004 that Mr. Renwick should receive, instead of additional cash compensation, a larger proportion of his potential compensation in the form of restricted stock and that his restricted stock awards should be equally weighted between time-based and performance-based shares. The value of his stock awards have remained at the same level since that time. In this way, we are able to keep Mr. Renwick s overall compensation at a competitive level, while further keeping a very high portion of his potential compensation at risk and dependent on Progressive s performance, increasing his equity participation and aligning his interests with those of long-term shareholders.

In the Compensation Committee s view, Mr. Renwick s performance as CEO clearly justified the continuation of his pay package for 2008 in the same format as prior years. Although he had the potential for above-market pay in the aggregate, the below-market base salary combined with the heavy reliance on performance-based bonus potential ties his total cash compensation to our insurance operating results. Moreover, the proportionately large restricted stock component, and the 50/50 split between time-based and performance-based restricted stock awards, was determined by the Committee to be an appropriate allocation to balance the related goals of encouraging Mr. Renwick s retention, providing him incentives to drive company performance and maximizing the extent to which his interests will be aligned with the interests of shareholders. If the aggressive performance growth target for the performance-based restricted stock award is not ultimately achieved, Mr. Renwick s actual total compensation attributable to 2008 will be well below the median compensation for CEO s at comparable companies. The Committee believes that this program presents a rational and strongly performance-based pay package for an outstanding CEO.

The result of these determinations for 2008 was that, despite his below median salary and bonus potential, Mr. Renwick had the potential to earn compensation that was ranked above the 50th percentile (assuming a cash bonus based on a 1.0 Gainsharing factor) and could approach the 75th percentile of comparable CEO compensation if performance-based compensation were to be maximized that is, if the cash bonus for 2008 were to be paid based on a 2.0 performance factor and all restricted stock awards ultimately vest. However, notwithstanding the fact that he was entitled to a Gainsharing bonus in the amount of approximately $935,000, Mr. Renwick recommended to the Committee that he be paid no cash bonus for 2008 in view of the significant deterioration in the company s investment portfolio during the year and the resulting adverse effects on our reported financial results. The Committee accepted his recommendation and, accordingly, no bonus was paid to Mr. Renwick for the year. Without the bonus, Mr. Renwick s total cash compensation was far below the median level for his comparison group. Moreover, even assuming the full vesting of his restricted stock awards for the year, which will remain at risk for several years, his total compensation will likely still remain below the 50th percentile ranking based on total compensation.

Other Named Executive Officers. Salaries for our other named executive officers are discussed above at page 23. The addition of variable compensation (i.e., the potential for cash bonuses and the possibility of restricted stock vesting in future years), as explained above, is typically expected to allow our executives the opportunity to earn above average compensation when justified by the company s performance and our stock price, although the comparison information is only one of a number of factors considered by the Committee in setting compensation each year, including the length of the named executive s tenure in the specific job, individual performance, expected future contributions, the reliability of the comparison data, our business needs, and the variable nature of significant portions of each executive s pay package.

Nonetheless, we recognize that such comparison data may be useful to shareholders to provide a context for executive compensation. The following information is accordingly based on the comparison information provided to the Committee at the beginning of 2008 and assumes Gainsharing bonus payments equal to the executive s target bonus amount (i.e., at a 1.0 Gainsharing factor) and full vesting of all equity awards. Based on those assumptions, three of our other named executive officers (Messrs. Cody, Domeck, and Jarrett) had total potential compensation that would rank below the median level for their respective comparison groups, while the potential compensation for the remaining three (Messrs. Sauerland and Voelker and Mrs. Griffith) would rank above their 50th percentile group, largely due to the impact of their cash bonus and equity award targets. Mr. Sauerland and Mrs. Griffith manage our two largest business groups, our Personal Lines and Claims operations, respectively, and Mr. Voelker is our Chief Information Officer.

It should be noted, however, that Gainsharing bonuses for 2008 were paid based on a .80 score, so each executive s actual compensation was below the value used in the comparisons above, underscoring the variable nature of the Gainsharing program, which is based on company performance. In addition, the vesting of the restricted stock awards, which is a large component of each executive s potential compensation, has not occurred and is not guaranteed. Each executive will ultimately receive the time-based awards only if he or she remains with Progressive throughout the applicable vesting periods, and the performance-based awards will vest only if Progressive satisfies the aggressive performance criteria established by the Committee (as described above). In addition, the value to be received by the executive, assuming that vesting does occur, will be dependent on the stock price at that time. Thus, for each named executive officer, a substantial portion of the compensation used to establish his or her potential percentile rank, and the value of those awards, will remain at risk for years before it is earned by the executive, and some of the restricted stock in fact may never vest.

Changes for 2009

Our compensation program for 2009 includes a number of changes from prior years. The changes are summarized as follows:

Executive Salaries. The Committee has determined, based on a recommendation from management, that there will be no raises in base salaries for 2009 for the CEO or each of the other named executive officers. This determination was made based on our overall results for 2008. Except as noted in the following paragraphs, other elements of the 2009 executive compensation program will remain substantially similar to 2008, as described in this report.

Gainsharing Calculations. For 2009, the Compensation Committee has determined that the bonus calculations for Mr. Renwick and Mr. Domeck, our CEO and the CFO, respectively, should include a component based on the performance of our fixed-income investment portfolio. This change has been made to reflect the CEO s and CFO s oversight responsibilities with respect to our investment operations, but was not extended to other senior executives because of their limited involvement with the investment group. Accordingly, although their respective total bonus potential has not increased from 2008 levels (Mr. Renwick s bonus target remains at 150% of salary and Mr. Domeck s target remains at 100%), in each case 25% of the performance factor used to determine their cash bonus awards will be determined from the results of the fixed-income portfolio, as further described above, with the remaining 75% being determined by the Core Business. However, the use of the investment component may not result in an increase in the bonus paid over the amount that would have been paid to each of them if their bonus had been calculated solely using the Core Business results. As a result, the use of the investment component can only serve to reduce the bonuses paid, but not increase them.

For our Chief Investment Officer, the Committee has determined that his cash bonus should be determined using a performance factor that is calculated 75% from the fixed-income investment results and 25% from the Core Business (while also not increasing his target bonus amount, which remains at 100% for 2009). In recent years, Mr. Cody s bonus has been calculated solely from investment results. This change will bring Mr. Cody s compensation in line with other employees in our investment operations, which reflects both the investment group s important role in ensuring that we have sufficient capital to support our insurance operations and our view that each employee should receive some benefit based on the results achieved by our insurance operations.

Performance-Based Restricted Stock Targets. In past years, our performance-based restricted stock has been set to vest if the company satisfies certain goals regarding growth and profitability that are established each year. Outstanding awards will expire if they do not vest after 10 years. Due to the cyclical nature of our industry and our changing view of growth potential, our growth targets have varied significantly from year to year, as shown by the following table:

Year of Restricted Stock Award	**Vesting Goal-Growth[1] (Net Premiums Earned) (billions)**
2003	$12.0
2004	15.0
2005	17.5
2006	20.0
2007	19.0
2008	16.5

[1]2003 award vested in July 2004; all other awards are unvested at this time.

For the performance-based restricted stock awards to be made in March 2009, the Committee has decided to change this program and to adopt a relative measure of performance that is based on total direct premiums written (while maintaining a profitability target of a combined ratio of 96 or less over the most recent 12 months, consistent with our awards in prior years). Specifically, the award will vest, if at all, only if the company s direct premiums written for a three-year period exceeds the growth rate of the market as a whole over that period by a margin that the Committee specifies in advance. We expect to use A.M. Best data, or other reliable market data, to make these calculations. This new program will also include a scaled vesting feature for the participants so that the number of shares vesting will increase as the company s relative performance versus the industry increases, up to a maximum number of shares established by the Committee for each participant. In the event that the growth goal is satisfied for the three-year period, but the profitability goal is not satisfied when the initial calculations are performed, the award will remain open for a limited time period (for example, for five years from the date of the award) in order to allow the opportunity to satisfy both goals. The Committee and management believe that this relative approach to measuring the company s growth against the industry s, as well as the shorter time frames covered by the awards, will lead to a more meaningful performance-based restricted stock program for participants.

OTHER ELEMENTS OF COMPENSATION

Perquisites

We provide limited perquisites to our executives and only do so when the Board or the Compensation Committee determines that such benefits are in the interests of Progressive and our shareholders. We own an aircraft that is used primarily for the CEO s business travel. At the request of the Board of Directors, the CEO also uses the company aircraft for his personal travel and some of his spouse s or other guest s personal travel when they accompany him. Such personal use of the aircraft constitutes a perquisite and is provided to enhance the CEO s and his family s personal security and the confidentiality of their travel. During 2008, we incurred approximately $83,802 in incremental costs as a result of Mr. Renwick s personal use of the aircraft. Such personal trips by the CEO also result in taxable income being imputed to him as required under IRS regulations, and he is responsible to pay the taxes on such income without further contribution (so-called gross up payments) from the company. Other executives may occasionally accompany the CEO on personal trips, at the CEO s discretion.

In addition, the CEO is provided with a company car and driver for his business needs to facilitate his transportation to and among our headquarters and many other local facilities, and to allow him to use that travel time for work purposes. To the extent that the CEO uses the company car for personal matters, including commuting to and from work, he receives a perquisite.

In prior years, our directors, the named executive officers and certain other senior executives, and their spouses or guests, were invited to attend a 2-day strategy session, which included a series of meetings between management and the Board and a regular Board meeting, at an off-site location. Personal travel for the spouses and certain costs for meals and other non-business activities during the retreat would constitute perquisites to the directors and executives who attend. In 2008 and 2009, however, the company did not pay for the expenses of spouses or guests at this event, and accordingly, no such perquisites were provided.

Otherwise, we do not provide perquisites to our executives. Disclosure of the incremental costs of perquisites to Progressive is included in the All Other Compensation column of the Summary Compensation Table on page 35.

Deferral Arrangements

The named executive officers and certain other senior-level employees are given the opportunity to defer the receipt of annual cash bonus awards and restricted stock awards under our Executive Deferred Compensation Plan (EDCP). This deferral mechanism operates solely as a vehicle for the executive to delay receipt of bonus income or the vesting of restricted stock awards that he or she otherwise would have earned as of a specific date. We do not contribute additional amounts to an executive s deferral accounts, either in the year of deferral or in future years. We also do not guarantee a specific investment return to executives who elect to participate in the deferral plan.

Deferred amounts are deemed to be invested in specific investments selected by the executive, including an option to invest in Progressive shares (subject to limitations included in the deferral plan), except that deferrals of restricted stock awards made in or after March 2005 are required to be invested in Progressive shares throughout the deferral period. The value of each executive s deferred account thus varies based on the executive s investment choices and market factors; these deferred amounts are at risk and may decrease in value if the investments selected by the executive do not perform well during the deferral period. Additional details concerning this plan, including the named executive officers respective holdings in the plan, can be found under the Nonqualified Deferred Compensation table and related disclosures, beginning on page 42 of this report.

The EDCP is made available to executives in order to keep our executive compensation program competitive, and to allow executives to manage their receipt of compensation to better fit their life circumstances and to manage their tax obligations. Moreover, the plan allows the executive to arrange for a portion of his or her income to be paid in post-employment years, which can be important because we do not offer a pension plan or supplemental retirement benefits to executives. Finally, to the extent that the top executives elect to defer time-based restricted stock until after they leave Progressive, this program is advantageous to the company to the extent that we otherwise might have lost a tax deduction upon the vesting of those shares under Internal Revenue Code §162(m) (see related discussion under Section 162(m) of the Internal Revenue Code below).

Retirement

Executives are eligible to participate in our retirement security program (401(k) plan) on the same terms and conditions as are available to all other regular employees, subject to limitations under applicable law. We do not provide other post-retirement payments or benefits to executives, such as a pension program or supplemental executive retirement plan, other than the following:

As discussed in the preceding section, executives who choose to participate in our deferral program may be entitled to receive post-employment payments of sums that he or she had previously earned (as increased or decreased by investment results), if he or she elected to receive such payments after leaving Progressive.

An executive who, at retirement, is 55 years of age or older and satisfies certain years-of-service requirements may be eligible to receive 50% of his or her unvested time-based restricted stock awards and to retain rights under certain unvested performance-based restricted stock awards (subject to the satisfaction of the applicable performance criteria) and all of his or her vested stock option awards. These rights are described in greater detail below under Potential Payments Upon Termination or Change in Control, beginning on page 44.

Severance and Change-in-Control Arrangements

Severance and change-in-control arrangements are intended to provide compensation and a fair financial transition for an executive when an adverse change in his or her employment situation is required due to our company needs or results from certain unexpected corporate events, and to recognize past contributions by such executives who are typically long-tenured employees. These arrangements allow the executive to focus on performance, and not his or her personal financial situation, in the face of uncertain or difficult times or events beyond his or her control. Each of these programs is discussed in more detail here and under Potential Payments upon Termination or Change in Control beginning on page 44.

Severance. Our executive separation allowance plan is designed to provide executives with well-defined financial payments if the executive s employment is terminated for any reason other than resignation (including retirement), death, disability, leave of absence or discharge for cause, if certain conditions are satisfied. For our senior executives, including the named executive officers, the severance payment would equal three years of the executive s base salary only (i.e., excluding cash bonuses and equity awards) at the time of termination, plus medical, dental and vision benefits for up to 18 months at regular employee costs. This same level of benefits is payable to the named executives upon any qualifying separation from Progressive, whether in a change-in-control situation or otherwise.

We believe that this level of severance payment (equal to three times the executive s base salary), whether or not triggered by a change in control, is reasonable based on available market data. The severance payments do not take into account the value of cash bonuses or equity-based awards in determining the executive s severance payment, which substantially limits the amount of the severance payment when compared with severance plans offered by many other companies. In addition, an executive who qualifies for a severance payment under this plan does not receive accelerated vesting of equity awards (although, in a change-in-control scenario, those awards may vest separately under the terms of our equity incentive plans, as discussed immediately below). Finally, the executive will receive no tax gross-up payment to compensate him or her for any taxes which he or she may be required to pay in connection with such payment. Management and the Committee accordingly believe that such severance rights provide executives with a fair, but not excessive, financial transition when an executive is asked to leave the company.

The dollar values of benefits payable to executives upon a qualifying termination under our severance plan are summarized below under Potential Payments upon Termination or Change in Control, beginning on page 44.

Change in Control Benefits under Equity Plans. Benefits are also provided to named executive officers and other recipients of equity awards under our equity plans upon the occurrence of a Change in Control or a Potential Change in Control, as defined in those plans (collectively, a Change in Control). The Board of Directors has the authority under the plans to override the Change in Control benefits, in an appropriate case, if the Board gives its prior approval to a transaction that would have otherwise triggered the benefits to be paid. If the Board s prior approval is not obtained, our equity plans provide for the immediate vesting of, and the immediate payment of the cash value of, the outstanding equity awards upon the occurrence of one of the specified triggering events. These provisions apply to both outstanding stock options (all of which are currently vested) and unvested restricted stock awards. Details concerning these provisions, including the definitions of Change in Control and Potential Change in Control, are provided beginning on page 45 under Change in Control Provisions under Equity Plans.

For restricted stock awards made in March 2007 or thereafter, the Board of Directors has modified our 2003 Incentive Plan (our only equity plan under which awards may currently be made to executives and other eligible employees) to remove from the definition of Potential Change in Control the approval by shareholders of an agreement that would give rise to a Change in Control. This change was viewed as appropriate by the Board and management for future awards to avoid a potential scenario in which rights are triggered under the plan, cash payouts are made as required, but the underlying transaction is not consummated as anticipated for some reason. This change was made on a going-forward basis only, and it does not affect rights under outstanding awards, which accrued under the plan before the change was made.

These Change in Control provisions have been included in our equity incentive plans since at least 1989. We believe that these provisions are similar to the change-in-control provisions included by many public companies in their equity plans. The provisions of our plans are designed to be triggered when a transaction occurs or is in process, without the prior approval of our Board of Directors that would be expected to result in an actual or effective change in control of the company. The Change in Control benefits would be paid upon the occurrence of a triggering event, even if an executive s employment with the company (or a successor company) is not terminated or threatened.

Any such change, or the impending prospect of such a change, would likely result in a significant alteration of, or at a minimum, cause tremendous uncertainty regarding, the employment situations of the most senior executives in the company. The loss of executive talent at such a critical juncture could be problematic for the company and its shareholders. By removing the additional uncertainty regarding outstanding equity plan benefits, these provisions are designed to enhance retention of executives and keep them focused on their business responsibilities in the face of such uncertain corporate events. Moreover, this process would also reduce executives legitimate concerns that, after the Change in Control, they could be subject to adverse employment actions, such as possible job loss, reduction in responsibilities, relocation or other actions intended to induce the executive to resign and forego benefits under the equity plans. While some of these adverse actions might be readily identifiable, such as a significant decrease in compensation or change in responsibilities, others might be more subtle and difficult to establish, such as exclusion from management meetings and policy decision-making. For these reasons, we believe that Change in Control benefits triggered by the change-in-control event, without requiring prior job loss, is appropriate. If a new controlling person desires to retain the services of one or more executives, it would be free to attempt to negotiate appropriate terms and conditions for their continuing employment.

Finally, it should be noted that although these provisions can operate automatically in a situation where the Change in Control is undertaken unilaterally, the Change in Control benefits may be withdrawn by the Board of Directors, in an appropriate case, if the persons seeking to acquire control of the company were to first come to the Board and negotiate to obtain the Board s consent to the triggering transaction. In this way, the plan provisions are further intended to foster a consensual process and a more orderly change in control, if such consent is requested and the transaction is approved. The Board believes such a process would benefit our shareholders, customers, employees, and other interested parties.

The dollar values of benefits payable to the named executive officers upon a change in control under our equity plans are summarized below under Potential Payments upon Termination or Change in Control, on page 44.

Death or Disability

Upon the death or permanent disability of one of our named executive officers, the officer (or his or her estate) will retain rights to any outstanding restricted stock awards that vest during the ensuing 12 months, whether they are time-based or performance-based awards, and all other restricted stock awards are forfeited. This benefit is available to all participants in our equity incentive plans. If the executive had elected to defer bonuses or restricted stock awards, he or she (or the estate) would also be entitled to receive distributions of those amounts in accordance with the executive s prior elections and the terms of the deferral plan. The executive (or upon death, his or her dependents) could also be entitled to receive certain health and welfare benefits as prescribed for all employees by Federal COBRA laws. No other post-employment payments would be made to the executives or his or her estate under these circumstances.

Health and Welfare Benefits

Named executive officers are also eligible to participate in our health and welfare plans, including medical and dental benefits, a 401(k) savings plan (with matching contributions by the company up to a specified annual limit), a limited life insurance benefit (with the ability to purchase additional coverage without company contribution), among other benefits. These plans are available on the same basis to all of our regular employees who satisfy minimum eligibility requirements.

RELATED CONSIDERATIONS

Section 162(m) of the Internal Revenue Code

Section 162(m) of the Internal Revenue Code limits to $1 million per year (Deduction Limit) the deduction allowed for Federal income tax purposes for compensation paid to the chief executive officer and the three other most highly compensated executives of a public company other than the chief financial officer (Covered Executives). This Deduction Limit does not apply to compensation paid under a plan that meets certain requirements for performance-based compensation. Generally, to qualify for this exception: (a) the compensation must be payable solely on account of the attainment of one or more pre-established objective performance goals; (b) the performance goals must be established by a compensation committee of the board of directors that is comprised solely of two or more outside directors ; (c) the material terms of the performance goals must be disclosed to and approved by shareholders before payment; and (d) the compensation committee must certify in writing prior to payment that the performance goals and any other material terms have been satisfied.

Our policy is to structure incentive compensation programs for Covered Executives to satisfy the requirements for the performance-based compensation exception to the Deduction Limit, and, thus, to preserve the deductibility of compensation paid to Covered Executives, to the extent practicable. Accordingly, our stock option, restricted stock, and cash bonus programs for our executives have been approved by shareholders and are implemented by the Compensation Committee in compliance with the requirements of Section 162(m). Several elements of our compensation program, however, constitute income that is not considered performance-based, including: base salary; the income recognized upon the vesting of time-based restricted stock awards (unless deferred by the executive); income arising from perquisites; dividends paid on unvested restricted shares; and certain distributions made to a Covered Executive under our executive deferral plan.

If the total of any Covered Executive s compensation that does not satisfy the performance-based compensation exception exceeds $1 million in any year, Progressive will not be entitled to deduct the amount that exceeds $1 million. Progressive and the Committee will continue to monitor the actual tax impact of such compensation strategies each year and consider such impact in making compensation decisions. We will not necessarily discontinue a compensation plan, however, that has a potential negative tax impact under Section 162(m). If we believe that the program in question (e.g., the use of time-based restricted stock) is appropriate and in the interest of shareholders, we will continue to use that type of compensation even though there are potential tax disadvantages to Progressive.

In 2008, the non-performance-based compensation earned by each of the Covered Executives was less than $1 million, except for our CEO, Mr. Renwick, who exceeded the Deduction Limit by approximately $70,000. His total non-performance-based compensation was principally comprised of his salary for the year, the amount of dividends paid on restricted stock awards and scheduled payments from his deferral account arising from cash bonuses that were deferred in 1995 and 1996. For 2009, we currently do not expect any of our named executive officers to exceed the $1 million Deduction Limit.

Section 409A of the Internal Revenue Code

Section 409A of the Internal Revenue Code sets forth requirements for non-qualified deferred compensation arrangements. These requirements apply to deferrals of compensation earned or vested after 2004. If deferrals do not comply with the requirements, the amount deferred is immediately includable in taxable income, subject to an additional 20% tax and interest.

Section 409A generally requires that elections to defer compensation must be made no later than the end of the year preceding the year the compensation is earned. Distributions of deferred compensation may be made only upon certain specified events, including death, disability, separation from service, unforeseeable emergency, change in control of the employer and expiration of a fixed deferral period. Section 409A also includes provisions restricting a deferred compensation plan participant s ability to accelerate, delay, or change the form of a scheduled distribution of deferred compensation.

Compensation arrangements that meet certain conditions may qualify for an exemption from Section 409A requirements. For example, an arrangement is exempt from Section 409A if it requires all payments to be made to a participant no later than 2-1/2 months following the end of the year in which the right to the payments was earned and vested. In addition, the arrangement will qualify for exemption if payments under the arrangement do not exceed certain limits and are payable no later than the end of the second year following the year the participant involuntarily separates from service.

All of our compensation plans, programs, and arrangements either qualify for exemption from Section 409A or have been amended to comply with Section 409A requirements. During 2007, we modified our executive deferred compensation plan and our director deferral plans so that all deferrals of compensation earned or vested after 2004 satisfy Section 409A, and to implement certain features permitted by the regulations with respect to such deferrals. Prior to the effectiveness of these amendments, we had operated our deferral plans in good faith compliance with Section 409A as to all deferrals made after 2004.

COMPENSATION COMMITTEE REPORT

The following Compensation Committee Report does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Progressive filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent Progressive specifically incorporates this Report by reference therein.

The Compensation Committee (the Committee) of the Board of Directors of The Progressive Corporation (Progressive) has reviewed and discussed with Progressive s management the Compensation Discussion and Analysis set forth above. Based on the review and discussions noted above, the Committee recommended to the Board that the Compensation Discussion and Analysis be included in Progressive s Proxy Statement for 2009, and incorporated by reference into Progressive s Annual Report on Form 10-K for the year ended December 31, 2008.

COMPENSATION COMMITTEE

Bradley T. Sheares, Ph.D., *Chairman*

Roger N. Farah

Norman S. Matthews

EXECUTIVE COMPENSATION

The following information is set forth with respect to the total compensation of our named executive officers (NEO) for 2008, who include each person who served as the Chief Executive Officer (CEO) or the Chief Financial Officer (CFO) during the year, our three other most highly compensated executive officers at year end and two other significant business leaders, who are also executive officers. The titles set forth below reflect positions held at December 31, 2008.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary[1] ($)	Stock Awards[2] ($)	Option Awards[3] ($)	Non-Equity Incentive Plan Compensation[4] ($)	All Other Compensation[5] ($)	Total ($)
Glenn M. Renwick	2008	$ 778,846	$ 4,974,429	$	$ [6]	$ 101,133	$ 5,854,408
President and Chief	2007	750,000	3,309,221		832,500	102,400	4,994,121
Executive Officer	2006	750,000	3,144,318	132,052	1,327,500	81,009	5,434,879
Brian C. Domeck	2008	$ 387,692	$ 356,243	$	$ 310,154	$ 11,862	$ 1,065,951
Vice President and	2007	317,693	229,395		235,092	11,625	793,805
Chief Financial Officer	2006	259,655	126,691	6,288	216,095	10,660	619,389
Charles E. Jarrett	2008	$ 424,038	$ 484,939	$	$ 339,231	$ 8,940	$ 1,257,148
Vice President, Secretary and	2007	393,269	332,225		291,019	8,700	1,025,213
Chief Legal Officer	2006	378,269	318,337	19,083	446,358	8,484	1,170,531
Susan Patricia Griffith	2008	$ 389,135	$ 483,133	$	$ 311,308	$ 12,052	$ 1,195,628
Claims Group President	2007	347,693	401,026		257,293	10,650	1,016,662
	2006	328,269	349,607	3,986	387,358	10,368	1,079,588
Raymond M. Voelker	2008	$ 377,307	$ 479,304	$	$ 301,846	$ 12,000	$ 1,170,457
Chief Information Officer	2007	347,692	400,972		268,071	11,625	1,028,360
	2006	328,269	352,715	16,143	398,190	11,310	1,106,627
John P. Sauerland	2008	$ 392,885	$ 355,980	$	$ 314,308	$ 10,980	$ 1,074,153
Personal Lines Group President	2007	328,942	227,739		305,916	10,650	873,247
	2006	273,754	133,872	5,983	261,654	10,368	685,631
William M. Cody	2008	$ 392,884	$ 452,215	$	$ [6]	$ 9,960	$ 855,059
Chief Investment Officer	2007	363,269	305,257			9,675	678,201
	2006	347,115	283,379	7,627	694,230	8,703	1,341,054

[1] Progressive pays employees on a bi-weekly basis, in an amount for salaried employees equal to 1/26th of his or her then-current annual salary rate. Typically, employees receive 26 paychecks in a calendar year. Every 10 to 11 years, however, the bi-weekly payment schedule results in an additional paycheck for each employee, including our named executive officers, as was the case in 2008. Accordingly, 2008 salary figures in the table above include an additional paycheck for each NEO, which resulted in an increase in their respective 2008 salaries of approximately 3.8% (or 1/26) above what would have been earned in a typical 26-paycheck year. The additional paycheck will not be paid in 2009, as we return to a 26 paycheck schedule.

[2] Represents expense recognized with respect to restricted stock awards granted from 2003 through 2008, in accordance with Statement of Financial Accounting Standards 123 (revised 2004) (SFAS 123(R)), Share-Based Payment. For awards granted in 2008, see the Grants of Plan-Based Awards table below.

Messrs. Renwick, Jarrett, and Cody, elected to defer the receipt of their 2003 and 2004 restricted stock awards pursuant to The Progressive Corporation Executive Deferred Compensation Plan (EDCP), under which such awards are accounted for as liability awards during the period prior to vesting. Under liability award accounting, the amount expensed reflects the fluctuations in the market price during the year, which results in a reduction in expense in years in which the stock price declines, such as in 2006, 2007, and 2008.

See Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table for a description of the timing and vesting terms of the 2008 restricted stock awards. Also see the Compensation Discussion and Analysis beginning on page 20 of this report, as well as *Note 9 Employee Benefit Plans* in Progressive s 2008 Annual Report to Shareholders included as an appendix to this Proxy Statement, for further discussion of the restricted stock awards and our recognition of expense relating to such awards.

[3] Represents expense recognized in accordance with SFAS 123(R) for nonqualified stock option awards granted in 2002. In 2003, we">

Cash and cash equivalents	$104,736	$25,712	$12,584	$18,561	$7,645
Working capital	130,760	47,021	32,452	12,970	14,729
Total assets	273,157	186,322	133,534	125,072	114,626
Total debt	--	34,125	--	25,000	34,548
Total stockholders' equity	221,666	105,611	90,084	53,239	40,730

Non-GAAP Financial Measures

We include in this Annual Report on Form 10-K the non-GAAP financial measure of EBITDA. We define EBITDA as income before interest, income taxes, depreciation and amortization. EBITDA is used as a supplemental financial measure by our management and by external users of our financial statements such as investors, commercial banks and others, to assess:

- the financial performance of our assets without regard to financing methods, capital structure or historical cost basis;
- the ability of our assets to generate cash sufficient to pay interest costs and support our indebtedness;

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- our operating performance and return on capital as compared to those of other companies in our industry, without regard to financing or capital structure; and
- the viability of acquisitions and capital expenditure projects and the overall rates of return on alternative investment opportunities.

EBITDA is not a presentation made in accordance with GAAP. EBITDA should not be considered an alternative to, or more meaningful than, net income, operating income, cash flows from operating activities or any other measure of financial performance presented in accordance with GAAP as measures of operating performance, liquidity or ability to service debt obligations. Because EBITDA excludes some, but not all, items that affect net income and is defined differently by different companies in our industry, our definition of EBITDA may not be comparable to similarly titled measures of other companies. EBITDA has important limitations as an analytical tool, and you should not consider it in isolation.

The following table provides a reconciliation of EBITDA to our net income for the periods indicated as calculated and presented in accordance with GAAP:

	2009	2008	2007	2006	2005
Net income	$20,030	$14,475	$17,399	$12,403	$5,311
Income tax expense	11,534	7,282	10,178	7,040	3,805
Interest expense(income), net	186	716	(90)	1,755	2,179
Depreciation and amortization*	18,788	18,848	12,592	11,805	11,036
EBITDA	$50,538	$41,321	$40,079	$33,003	$22,331

*includes depreciation, amortization of finite-lived intangible assets and amortization of deferred financing costs

Selected Quarterly Financial Data

The following table sets forth selected unaudited financial information for the eight quarters in the two-year period ended December 31, 2009. This information has been prepared on the same basis as the audited financial statements and, in the opinion of management, contains all adjustments necessary for a fair presentation.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
2009					
Revenues	$70,040	$70,753	$81,466	$71,235	$293,494
Operating profit(a)	7,074	10,136	8,300	6,241	31,750
Income before income taxes	6,971	10,000	8,289	6,304	31,564
Net income	4,341	6,286	5,397	4,006	20,030
Earnings per share:					
Basic	$0.20	$0.29	$0.22	$0.15	$0.85
Diluted	$0.20	$0.28	$0.22	$0.15	$0.84

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
		(in thousands, except per share data)			
2008					
Revenues	$52,591	$67,070	$62,897	$79,244	$261,802
Operating profit(a)	4,245	4,135	5,243	8,851	22,474
Income before tax	4,268	3,890	4,985	8,614	21,757
Net income	2,846	2,401	3,764	5,464	14,475
Earnings per share:					
Basic	$0.13	$0.11	$0.18	$0.25	$0.67
Diluted	$0.13	$0.11	$0.17	$0.25	$0.66

(a) Operating profit represents revenues, less cost of contracts and selling, general and administrative expenses

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Item 7.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations is based on and should be read in conjunction with our consolidated financial statements and the accompanying notes beginning on page F-1 of this Annual Report on Form 10-K. Certain statements made in our discussion may be forward-looking. Forward-looking statements involve risks and uncertainties and a number of factors could cause actual results or outcomes to differ materially from our expectations. See "Forward-Looking Statements" at the beginning of this Annual Report on Form 10-K for additional discussion of some of these risks and uncertainties. Unless the context requires otherwise, when we refer to "we", "us" and "our", we are describing Orion Marine Group, Inc. and its consolidated subsidiaries.

Overview

We are a leading marine specialty contractor serving the heavy civil marine infrastructure market. We provide a broad range of marine construction and specialty services on, over and under the water along the Gulf Coast, the Atlantic Seaboard and the Caribbean Basin, and we recently expanded into the Pacific Northwest. Our customers include federal, state and municipal governments, the combination of which accounted for approximately 55% of our revenue in the year ended December 31, 2009, as well as private commercial and industrial enterprises. We are headquartered in Houston, Texas.

2009 Recap and 2010 Outlook

Despite a difficult and challenging economic environment, our revenues increased 12.1% in 2009 as compared with 2008. The mix of contracts in progress and those completed during 2009 shifted more toward the public sector, with 55% of 2009 revenue generated from federal and state agencies and local municipalities, which includes the US Army Corps of Engineers.

In 2009, pursuant to a shelf registration on Form S-3, we completed a public offering of 4.8 million shares of our common stock at $19.70 per share, and received net proceeds of $91.0 million. With a portion of the proceeds, we repaid all of our outstanding debt of approximately $29.9 million.

We invested in specialized equipment to enhance our lift capabilities and expand our fleet. Our capital expenditures in 2009 totaled $22.7 million.

During the year ended December 31, 2009, our operations provided cash from operations of $40.3 million and our cash position at December 31, 2009 exceeded $104.7 million. Our operations are not currently dependent on external sources of capital and we have not utilized the $7.6 million available to us under our revolving credit facility.

Our overall performance generally depends on spending in the heavy civil marine infrastructure market. Spending by our customers, both government and private, is impacted by several important trends affecting our industry, including the following:

- port and channel expansion and maintenance;
- deteriorating condition of intracoastal waterways and bridges;
- continued demand in the cruise industry;
- infrastructure spending by the United States Navy and Coast Guard;
- near-shore oil and gas capital expenditures
- ongoing U.S. coastal wetlands restoration and reclamation;
- recurring hurricane restoration and repair.

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In January 2010, we acquired Texas-based T.W. LaQuay Dredging, LLC for $64 million in cash, utilizing proceeds raised in our August 2009 public stock offering to fund the acquisition. The acquisition provided us with additional dredging resources for deep-channel dredging capability as well as additional experienced personnel. Through its backlog of approximately $25 million, the acquisition will immediately contribute to 2010 revenue.

In February 2010, we expanded our operations and established a base in the Pacific Northwest through the purchase of several heavy civil marine construction equipment items, including derrick barges, cranes, hammers and ancillary equipment, at a total price of $7.0 million.

We continue to see good bidding opportunities in our end markets. Sources of bid opportunities available to us include:

- Gulf Coast and Southeast Atlantic ports, which are expected to continue with expansion plans, with supplemental funding available from the American Recovery and Reinvestment Act (the “Stimulus package”).
- Bridge maintenance, alterations, and construction, which should be a priority for states, with funding from highway transportation programs and through the Stimulus package.
  - Funds available from the civil works budget and Stimulus package of the US Army Corps of Engineers.
- The continuation of the highway transportation program for highway construction, including bridges over water.

Our focus in 2010 will be to concentrate on our core business objectives; to manage our business effectively and efficiently; to pursue rational growth strategies while closely monitoring the costs of our operations; and to maintain our strong balance sheet.

Critical Accounting Policies

The consolidated financial statements contained in this report were prepared in accordance with accounting principles generally accepted in the United States (“US GAAP”). The preparation of these financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect both the Company’s carrying values of its assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Although our significant accounting policies are described in more detail in Note 2 of the Notes to Consolidated Financial Statements; we believe the following accounting policies to be critical to the judgments and estimates used in the preparation of our financial statements.

Revenue Recognition

We enter into construction contracts principally on the basis of competitive bids. Although the terms of our contracts vary considerably, most are made on a fixed price basis. Revenues from construction contracts are recognized on the percentage-of-completion method. The percentage-of-completion method measures the ratio of costs incurred and accrued to date for each contract to the estimated total costs for each contract at completion. This requires us to prepare on-going estimates of the costs to complete each contract as the project progresses. In preparing these estimates, we make significant judgments and assumptions concerning our significant cost drivers of materials, labor and equipment, and we evaluate contingencies based on possible schedule variances, production delays or other productivity factors.

Actual costs may vary from the costs we estimated. Variations from estimated contract costs along with other risks inherent in fixed price contracts may result in actual revenue and gross profits differing from those we estimated and could result in losses on projects. If a current estimate of total contract cost indicates a loss on a contract, the projected loss is recognized in full when determined, without regard to the percentage of completion. We consider unapproved change orders to be contract variations on which we have customer approval for scope change, but not for price associated with that scope change. These costs are included in the estimated cost to complete the contracts and are expensed as incurred. We recognize revenue equal to cost incurred on unapproved change orders when realization of

price approval is probable and the estimated amount is equal to or greater than our cost related to the unapproved change order and the related margin when the change order is formally approved by the customer. Revenue recognized on unapproved change orders is included in contract costs and estimated earnings in excess of billings on uncompleted contracts on the balance sheet. We consider claims to be amounts that we seek or will seek to collect from customers or others for customer-caused changes in contract specifications or design, or other customer-related causes of unanticipated additional contract costs on which there is no agreement with customers on both scope and price changes. Revenue from claims is recognized when
agreement is reached with customers as to the value of the claims, which in some instances may not occur until after completion of work under the contract. Costs associated with claims are included in the estimated costs to complete the contracts and are expensed when incurred. Depending on the size of a particular project, variations from estimated project costs could have a significant impact on our operating results for any fiscal quarter or year. We believe our exposure to losses on fixed price contracts is limited by the relatively short duration of the contracts we undertake and our management's experience in estimating contract costs. We provide for contract losses in their entirety in the period they become known, without regard to the percentage of completion.

Long-Lived Assets
Fixed assets are carried at cost and are depreciated over their estimated useful lives, ranging from one to thirty years, using the straight-line method for financial reporting purposes and accelerated methods for tax reporting purposes. The carrying value of all long-lived assets is evaluated periodically to determine if adjustment to the depreciation period or the carrying value is warranted. If events and circumstances indicate that the long-lived assets should be reviewed for possible impairment, we use projections to assess whether future cash flows on a non-discounted basis related to the tested assets are likely to exceed the recorded carrying amount of those assets to determine if write-down is appropriate. If we identify impairment, we will report a loss to the extent that the carrying value of the impaired assets exceeds their fair values as determined by valuation techniques appropriate in the circumstances that could include the use of similar projections on a discounted basis.

Goodwill

We have acquired businesses and assets in purchase transactions that resulted in the recognition of goodwill. In accordance with US GAAP, acquired goodwill is not amortized, but is subject to impairment testing at least annually or more frequently if events or circumstances indicate that the asset more likely than not may be impaired.

We assess the fair value of our reporting units based on a weighted average of valuations based on market multiples, discounted cash flows, and consideration of our market capitalization. The key assumptions used in the discounted cash flow valuations are discount rates and perpetual growth rates applied to cash flow projections. Also inherent in the discounted cash flow valuation models are past performance, projections and assumptions in current operating plans, and revenue growth rates over the next five years. These assumptions contemplate business, market and overall economic conditions. We also consider assumptions that market participants may use.

As required by the Company's policy, annual impairment tests of goodwill are performed during the fourth quarter of each year or when circumstances arise that indicate a possible impairment might exist. Based on this testing, we determined that goodwill was not impaired as of October 31, 2009, and no events have occurred since that date that would require an interim impairment test. The discount rate used in testing goodwill for impairment was 15.3%. Revenue growth was fixed at 5% per year, which we believe is appropriate based on our assessment of current economic and market conditions. As compared with the impairment test performed in 2008, the discount rate increased by 80 basis points, due to our assessment of economic conditions and risk, while the revenue growth rate remained constant. This had the effect of reducing the indicated fair value in the 2009 test. Management performed a sensitivity analysis on the fair value resulting from the discounted cash flow valuation, by increasing the discount rate 100 basis points and decreasing the perpetual growth rate by 100 basis points. The results of the sensitivity analysis indicated no impairment in goodwill.

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Income Taxes

We account for income taxes using the asset and liability method prescribed by US GAAP. We evaluate valuation allowances for deferred tax assets for which future realization is uncertain. The estimation of required valuation allowance includes estimates of future taxable income. In our assessment of our deferred tax assets at December 31, 2009, we considered that it was more likely than not that all of the deferred tax assets would be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

The Company accounts for uncertain tax positions in accordance with the provisions ASC 740-10, which it adopted on January 1, 2007, which prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken, or expected to be taken, on our consolidated tax return. We evaluate and record any uncertain tax positions based on the amount that management deems is more likely than not to be sustained upon ultimate settlement with the tax authorities in the tax jurisdictions in which we operate.

Insurance Coverage, Litigation, Claims and Contingencies

We maintain insurance coverage for our business and operations. Insurance related to property, equipment, automobile, general liability and a portion of workers' compensation is provided through traditional policies, subject to a deductible. A portion of our workers' compensation exposure is covered through a mutual association, which is subject to supplemental calls.

The Company maintains two levels of excess loss insurance coverage, $20 million in excess of primary coverage and $10 million in excess of the $20 million, which excess loss coverage responds to all of the Company's insurance policies other than a portion of its Workers' Compensation coverage and employee health care coverage. The Company's excess loss coverage responds to most of its policies when a primary limit of $1 million has been exhausted; provided that the primary limit for Maritime Employer's Liability is $10 million and the Watercraft Pollution Policy primary limit is $5 million.

We have elected to retain a portion of losses that may occur through the use of various deductibles, limits and retentions under our insurance programs. Losses on these policies up to the deductible amounts are accrued in our consolidated financial statements based on known claims incurred and an estimate of claims incurred but not yet reported. We derive our accruals from known facts, historical trends and industry averages to determine the best estimate of the ultimate expected loss. Actual claims may vary from our estimate. We include any adjustments to such reserves in our consolidated results of operations in the period in which they become known.

Accounting for Stock Issued to Employees and Others

We measure the cost of equity compensation to our employees and independent directors based on the estimated grant-date fair value of the award and recognize the expense over the vesting period. We use the Black-Scholes option pricing model to compute the fair value of the awards of equity instruments. The Black-Scholes model requires the use of highly subjective assumptions in the computation. Changes in these assumptions can cause significant fluctuations in the fair value of the option award.

Consolidated Results of Operations

Current Year—Year Ended December 31, 2009 compared with Year Ended December 31, 2008

The following information is derived from our historical results of operations (dollars in thousands):

	Twelve months ended December 31, 2009		Twelve months ended December 31, 2008	
	Amount	Percent	Amount	Percent
Contract revenues	$293,494	100.0 %	$261,802	100.0 %
Cost of contract revenues	230,797	78.6 %	211,351	80.7 %
Gross profit	62,697	21.4 %	50,451	19.3 %
Selling, general and administrative expenses	30,947	10.5 %	27,978	10.7 %
Operating income	31,750	10.9 %	22,473	8.6 %
Interest (income) expense				
Interest (income)	(352)	-0.1 %	(530)	-0.2 %
Interest expense	538	0.2 %	1,246	0.5 %
Interest (income) expense, net	186	0.1 %	716	0.3 %
Income before income taxes	31,564	10.8 %	21,757	8.3 %
Income tax expense	11,534	3.9 %	7,282	2.8 %
Net income	$20,030	6.9 %	$14,475	5.5 %

Contract Revenues. Total revenue in 2009 increased $31.7 million or 12.1%, as compared with 2008. The increase in revenue was attributable, in part, to expansion of our dredging capabilities along the eastern coast of the United States late in the first quarter of 2008 and to the progress schedules and rate of completion of the contracts in progress in 2009. Our mix of projects during the year shifted toward the public sector, which totaled 55.2% of 2009 revenues, with revenues generated from the private sector representing 44.8%. In 2008, 50.1% of revenues were generated from government agencies and 49.1% from the private sector. An increase in spending by the Corps of Engineers, partly targeting economic recovery, resulted in 18.5% of total revenues generated from federally funded projects, as compared with 11.1% in the prior year.

Gross Profit. Gross profit increased by $12.2 million, or 24.3% and gross margin improved to 21.4% in 2009 from 19.3% in 2008. We achieved an improvement in gross margin despite a reduction in our contract self-performance rate to 87.6% of total costs, as compared with a self-performance rate of 88.2% in 2008. During 2008, significant production delays which resulted from unexpected amounts of trash and unforeseen site conditions on two projects involving dredging services, negatively affected gross margins.

Selling, General and Administrative Expense. As compared with the prior year, selling, general and administrative expenses (“SG&A”) increased $3.0 million or 10.6% in 2009. The increase was due primarily to additional overheads to support our business growth. In the prior year, we benefitted from lower group medical and workers’ compensation expenses.

Income Tax Expense. Our effective rate for the year ended December 31, 2009 was 36.5% and differed from the Company’s statutory rate of 35% primarily related to state income taxes and the non-deductibility of certain permanent tax items, such as incentive stock compensation expense, offset in part by the benefit of the domestic production activities deduction on our federal tax return, which net effect increased our overall effective tax rate. Our effective tax rate of 33.5% in 2008 differed from our statutory rate of 35%, primarily due to the benefit of the domestic production activities deduction on the Company’s tax return and true-ups of federal and state deferred taxes.

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Prior Year—Year Ended December 31, 2008 compared with Year Ended December 31, 2007

The following information is derived from our historical results of operations (dollars in thousands):

	Twelve months ended December 31,			
	2008		2007	
	Amount	Percent	Amount	Percent
Contract revenues	$261,802	100.0 %	$210,360	100.0 %
Cost of contract revenues	211,351	80.7 %	159,927	76.0 %
Gross profit	50,451	19.3 %	50,433	24.0 %
Selling, general and administrative expenses	27,978	10.7 %	22,946	10.9 %
Operating income	22,473	8.6 %	27,487	13.1 %
Interest (income) expense				
Interest (income)	(530)	-0.2 %	(1,000)	-0.5 %
Interest expense	1,246	0.5 %	910	0.5 %
Interest (income) expense, net	716	0.3 %	(90)	0.0 %
Income before income taxes	21,757	8.3 %	27,577	13.1 %
Income tax expense	7,282	2.8 %	10,178	4.8 %
Net income	$14,475	5.5 %	$17,399	8.3 %

Contract Revenues. Total revenue increased $51.4 million or 24.5%, from $210.4 million for the year ended December 31, 2007 to $261.8 million for the year ended December 31, 2008. The increase in revenue was due to geographic expansion of our dredging capabilities along the eastern coast of the United States and to the progress schedules and rate of completion of the contracts in progress in 2008, despite an active hurricane season in the year with seven named storms that affected our entire operations at various times. Revenues generated by the private sector increased by a substantial 45% in 2008 as compared with 2007. However, revenues generated from federal agencies decreased by 22.4% in 2008 as compared with 2007 due to a slow volume of bid opportunities by the Corps of Engineers.

Gross Profit. Gross profit was comparable to the prior year, however, gross margin decreased from 24.0% in 2007 to 19.3% in 2008. The downward pressure on margin was due primarily to the use of outside subcontractors resulting from the scope of work in the mix of contracts in progress during 2008, which reduced our self-performance rate (as measured by cost) from 90.3% in 2007 to 88.2% in 2008. Significant production delays which resulted from unexpected amounts of trash and unforeseen site conditions on two projects involving dredging services, negatively affected gross margins. In addition, we achieved higher margins on certain projects in 2007, due to productivity gains on labor and other factors.

Selling, General and Administrative Expense. As compared with the prior year, selling, general and administrative expenses (“SG&A”) increased $5.0 million or 21.9% in 2008. Current year expenses include amortization related to intangible assets; additional overheads to support the business growth we experienced in 2008; and a full complement of annual public company expenses. In addition, we increased our bad debt reserve to $0.8 million, related to receivables on two projects, and our property taxes increased as compared with 2007, due in part to property taxes related to our geographic expansion. In the prior year, we incurred one-time payments of bonuses and incentives to key employees upon the successful consummation of the common stock offering in May 2007, which totaled approximately $2.6 million. As a percentage of revenues, however, SG&A expenses decreased slightly, from 10.9% of revenues to 10.7%, reflecting our continued focus on the management of costs.

Interest Expense, net of Interest Income. The increase in interest expense in 2008 directly resulted from debt incurred to purchase assets in February 2008. In 2007, upon closing of the private placement transaction, we repaid all debt outstanding at that time. We earn interest income on the cash balances we maintain throughout the year.

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Income Tax Expense. Our effective tax rate of 33.5% differed from our statutory rate of 35%, primarily due to the benefit of the domestic production activities deduction on the Company's tax return and true-ups of federal and state deferred taxes. Excluding these true-ups, our effective tax rate was 36.4% and differed from the statutory rate due to our estimate of the impact of certain permanent deductions available on our federal tax return, offset by increases in state income taxes. The effective rate of 36.9% in 2007 differed from the statutory rate primarily due to permanent non-deductible differences and to state income taxes.

Liquidity and Capital Resources

Our primary liquidity needs are for financing working capital, investment in capital expenditures and strategic acquisitions. Historically, our sources of liquidity have been cash provided by our operating activities and borrowings under our credit facility.

Our working capital position fluctuates from period to period due to normal increases and decreases in operations activity. At December 31, 2009, our working capital was $130.8 million, of which $53.4 million was related to the balance of the proceeds received from the sale of common stock in August 2009, as compared to working capital of $47.0 million at December 31, 2008.

As of December 31, 2009, we had available cash on hand and availability under our revolving credit facility of $112.3 million.

At December 31, 2009, our operations provided cash from operations of $40.3 million. Our operations are not currently dependent on external sources of capital, and we have not utilized our available borrowing of $7.6 million under our revolving credit facility.

We expect to meet our future internal liquidity and working capital needs, and maintain our equipment fleet through capital expenditure purchases and major repairs, from funds generated in our operating activities, and from the proceeds received from our common stock offering, for at least the next 12 months. We believe our cash position, combined with the capacity available under our revolving credit facility, is adequate for our general business requirements. Subsequent to year end, we utilized approximately $64 million of cash to purchase T.W. LaQuay Dredging, LLC ("TWLD"), and approximately $7.0 million to purchase marine construction assets in the Pacific Northwest.

The following table provides information regarding our cash flows and our capital expenditures for the years ended December 31, 2009, 2008 and 2007:

	Year ended December 31,		
	2009	2008	2007
		(in thousands)	
Cash provided by (used in):			
Operating activities…………………………………………............	$40,336	$26,471	$10,092
Investing activities………………………………………………...	(21,598)	(47,337)	(9,463)
Financing activities…………………………………………............	60,286	33,994	(6,606)
Capital expenditures (included in investing activities above)………	22,693	14,485	11,433

Operating Activities. Fluctuations in cash generated by operating activities are generally the result of timing differences related to the nature and volume of contracts in any given year. Our operations provided net cash of $40.3

million during fiscal 2009. The increase of $13.9 million, as compared with 2008 was due to:

- An increase of $5.6 million in net income;
- A reduction in our deferred income taxes of $1.0 million ; and
- An increase of $7.3 million in working capital components, as described below.

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In 2009, the changes in working capital included an increase in trade payables of $11.2 million compared with 2008, related to the timing of payments to vendors, and based on the mix of contracts in progress. Amounts remaining unbilled to customers, net of our liability related to the receipt of progress payment on certain projects, increased by $9.7 million as compared with 2008, and was related to the timing of billings to customers and the utilization of progress payments. We manage our working capital components in total, rather than by the individual elements, and fluctuations in accounts receivable and payable balances are normal within our business.

In 2008, our accounts receivable and payable balances increased by $4.6 million and $1.8 million, respectively, and our billings to customers exceeded unbilled amounts to customers on our contracts in progress.

Investing Activities. We purchase capital equipment as well as perform major maintenance and upgrades of our existing fleet and construction equipment to support our construction activities. Capital expenditures supporting our operations and enhancing our fleet totaled $22.7 million in 2009, an increase of $8.2 million as compared with 2008. Also in 2008, we purchased assets to expand our dredging capabilities along the Atlantic Seaboard for a total purchase price of $36.7 million. Proceeds from the sale of property and equipment in 2008 include $2.8 million received from the sale of a vessel no longer considered integral to our fleet.

Financing Activities. In August 2009, we completed a public offering of common stock, receiving proceeds, net of expenses, of approximately $91.0 million. With a portion of the proceeds, we repaid the outstanding balance on our credit facility. In addition, we received proceeds from stock option exercises, including related tax benefits of $3.4 million. Cash provided by financing activities in 2008 was attributable to our borrowing of $35.0 million under our line of credit to fund the purchase of assets. In 2007, net proceeds from the sale of our common stock in a private placement transaction totaled approximately $18.5 million, which we used to repay our debt facility.

Sources of Capital

In addition to our cash balances and cash provided by operations, we have a credit facility available to us to finance capital expenditures and working capital needs.

In February 2008, the Company borrowed $35 million under its credit facility to fund the purchase of marine construction equipment and related assets. In August 2009, the Company repaid the outstanding balance on the credit facility of $29.9 million from proceeds received from its common stock offering. The Company currently has the availablity to borrow up to $15 million under an acquisition term loan facility and up to $8.5 million under a revolving line of credit. All provisions under the credit facility mature on September 30, 2010.

The revolving line of credit is subject to a borrowing base and availability on the revolving line of credit is reduced by any outstanding letters of credit. At December 31, 2009, the Company had outstanding letters of credit of $910,000, thus reducing the balance available to the Company on the revolving line of credit to approximately $7.6 million. The Company is subject to a monthly commitment fee on the unused portion of the revolving line of credit at a current rate of 0.20% of the unused balance. As of December 31, 2009, no amounts had been drawn under the revolving line of credit.

The credit facility is secured by the bank accounts, accounts receivable, inventory, equipment and other assets of the Company and its subsidiaries and places restrictions on the Company as to its ability to incur additional debt, pay dividends, advance loans, and engage in other actions. The credit facility also requires the Company to maintain certain financial ratios as follows:

- A minimum net worth in the amount of not less than the sum of $40.0 million plus 50% of consolidated net income earned in each fiscal quarter ended after December 31, 2006 plus adjustments for certain equity transactions;
- A minimum fixed charge coverage ratio of not less than 1.30 to 1.0 as of each fiscal quarter end; and
- A total leverage ratio not greater than 3.0 to 1.0 as of each fiscal quarter end.

At December 31, 2009, the Company was in compliance with all its financial covenants with a sufficient margin as to not impair its ability to incur additional debt or violate the terms of its credit facility. Historically, the Company has not relied on debt financing to fund its operations or working capital.

The Company is in negotiations to renew its credit facility prior to the September 30, 2010 expiration.

Bonding Capacity

We are generally required to provide various types of surety bonds that provide additional security to our customers for our performance under certain government and private sector contracts. Our ability to obtain surety bonds depends on our capitalization, working capital, past performance and external factors, including the capacity of the overall surety market. At December 31, 2009, we believe our capacity under our current bonding arrangement was in excess of $400 million, of which we had approximately $130 million in surety bonds outstanding. We believe our strong balance sheet and working capital position will allow us to continue to access our bonding capacity.

Effect of Inflation

We are subject to the effects of inflation through increases in the cost of raw materials, and other items such as fuel. Because the typical duration of a project is between three to nine months we do not believe inflation has had a material impact on our operations.

Off Balance Sheet Arrangements

We currently have no off balance sheet arrangements, other than operating leases to which we are a party, and which arise in the normal course of business. These arrangements are not reasonably likely to have an effect on our financial condition, or results of operations that is material to investors. See Note 20 – Commitments and Contingencies of Notes to Consolidated Financial Statements beginning on page F-1 of this Annual Report on Form 10-K.

Contractual Obligations

The following table sets forth information about our contractual obligations and commercial commitments as of December 31, 2009:

			Payment Due by Period		
	Total	< 1 year	1-3 years	3-5 years	> 5 years
			(in thousands)		
Long-term debt obligations………..	$--	$--	$--	$---	$---
Operating lease obligations…………..	8,153	2,981	3,477	1,181	514
Purchase obligations (1)…………….	--	--	---	---	---
Total…………………………………...	$8,153	$2,981	$3,477	$1,181	$514

(1) Commitments pursuant to other purchase orders and subcontracts related to construction contracts are not included since such amounts are expected to be funded under contract billings.

To manage risks of changes in the material prices and subcontracting costs used in tendering bids for construction contracts, we obtain firm quotations from our suppliers and subcontractors before submitting a bid. These quotations do not include any quantity guarantees, and we have no obligation for materials or subcontract services beyond those required to complete the contracts that we are awarded for which quotations have been provided.

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Subsequent Events

On January 28, 2010, Seagull Services, LLC, a wholly-owned subsidiary of the Company purchased (a) the membership interests of TWLD, a Texas limited liability company, from LaQuay Holdings, Inc. (the “Seller”), (b) all of the issued and outstanding capital stock of Industrial Channel and Dock, Company, a Texas Corporation, and Commercial Channel and Dock Company, a Texas Corporation (collectively, the “Channel and Dock Companies”), from Timothy W. LaQuay and Linda F. LaQuay (the principal shareholders of the Seller, the “Principal Shareholders”), and (c) certain parcels of real property located in Calhoun County, Port Lavaca, Texas from the Principal Shareholders (collectively, the “Purchase Transactions”). At the closing, the Company entered into a consulting agreement with Timothy and Linda LaQuay and with Charles F. Barnett for a term of one year from the Closing Date.

Upon the terms of and subject to the conditions set forth in the Purchase Agreement, the total aggregate consideration paid by the Company to the Seller and the Principal Shareholders consisted of the following:

- Cash consideration of $55.5 million, paid to the Seller for the membership interests of T.W. LaQuay Dredging;
- Cash consideration of $4.5 million, paid to the Principal Shareholders for the Channel and Dock Companies and the above mentioned parcels of land; and
- Up to an additional $4.0 million (to be held in escrow) payable to Seller as a result of an increase in the purchase price of the membership interests by the amount of any additional taxes incurred by the Seller arising from the allocation of the membership interests purchase price, as further described in Section 1060 of the U.S. Internal Revenue Code, as amended.

The Purchase Agreement contains customary representations, warranties, covenants and indemnities, including certain post-closing covenants with respect to confidentiality and non-competition.

The following table summarizes the preliminary allocation of the purchase price:

Fair value of working capital items	$ 4,007
Property and equipment	$48,594
Goodwill	$11,399
Total	$64,000

The purchase price has been allocated to the assets acquired and the liabilities assumed using estimated fair values as of the acquisition date. The estimates and assumptions are subject to change upon the finalization of valuations, which are contingent upon final appraisals of property and equipment, identifiable intangible assets, and other adjustments through January 28, 2010. Revisions to the preliminary purchase price allocation could result in significant deviations from the preliminary allocation.

On February 11, 2010, the Company purchased several heavy civil marine construction equipment items including derrick barges, cranes, hammers and ancillary equipment from a private company exiting the marine construction business, for a purchase price of approximately $7.0 million. The Company intends to establish a base to serve the Pacific Northwest and West Coast, through the lease of yard and office space in Tacoma, Washington. The Company is currently evaluating the fair value of the assets acquired.

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Recently Issued Accounting Pronouncements

Disclosures about Fair Value Measurements

In January 2010, the FASB issued a new accounting standard update ("ASU") which clarifies and provides additional disclosure requirements on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons for and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). This ASU is effective for us in 2010, except for the requirements to provide Level 3 activity which will become effective for us in 2011. We do not expect the adoption of this ASU to have a material effect on our consolidated financial statements.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not enter into derivative financial instruments for trading, speculation or other purposes that would expose the Company to market risk. In the normal course of business, our results of operations are subject to risks related to fluctuation in commodity prices and fluctuations in interest rates.

Commodity price risk
We are subject to fluctuations in commodity prices for concrete, steel products and fuel. Although we attempt to secure firm quotes from our suppliers, we generally do not hedge against increases in prices for concrete, steel and fuel. Commodity price risks may have an impact on our results of operations due to the fixed-price nature of many of our contracts, although the short-term duration of our projects may allow us to include price increases in the costs of our bids.

Interest rate risk
At December 31, 2009, we had no borrowings under our revolving credit facility or line of credit. Our credit facility expires in September 2010. Our objectives in managing interest rate risk are to lower our overall borrowing costs and limit interest rate changes on our earnings and cash flows. To achieve this, we closely monitor changes in interest rates and we utilize cash from operations to reduce our debt position. An increase of 1% in our interest rate during 2009 would have increased our interest expense by approximately $208,000.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
The information required by this Item 8 is submitted as a separate section beginning on page F-1 of this Annual Report on Form 10-K and is incorporated herein by reference.

Additionally, a two-year Summary of Selected Quarterly Financial Data (unaudited) is included in "Selected Quarterly Financial Data" under Item 6 - Selected Financial Data.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

Item 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We maintain a set of disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) under the

Exchange Act) as of the end of the period covered by this report. Based on such evaluation, our principal executive and financial officers have concluded that our disclosure controls and procedures were effective as of the end of such period.

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Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting can also be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management conducted an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria described in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that our internal control over financial reporting was effective as of December 31, 2009.

Grant Thornton LLP, an independent registered accounting firm, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting and issued an audit report thereon, which is included in this Annual Report on Form 10-K

Changes in Internal Control

There were no changes in the Company's internal control over financial reporting during the Company's quarter ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. OTHER INFORMATION

None

PART III

Certain information required by Part III is omitted from this Report. We will file our definitive proxy statement for our Annual Meeting of Stockholders to be held on May 20, 2010 (the "Proxy Statement") pursuant to regulation 14A not later than 120 days after the end of the fiscal year covered by this Annual Report, and certain information included therein is incorporated by reference herein.

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors, Executive Officers, Promoters and Control Persons

The information required by Paragraph (a), and Paragraphs (c) through (g) of Item 401 of Regulation S-K (except for information required by Paragraph (e) of that Item to the extent the required information pertains to our executive officers) is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year.

The following table presents the information required by Paragraph (b) of Item 401 of Regulation S-K.

Name	Age	Position with the Company	Year Joined the Registrant
Richard L. Daerr, Jr.	65	Chairman of the Board	2007
J. Michael Pearson	62	President, Chief Executive Officer and Director	2006
Thomas N. Amonett	66	Director	2007
Austin J. Shanfelter	52	Director	2007
Gene Stoever	71	Director	2007
Mark R. Stauffer	47	Executive Vice President and Chief Financial Officer	1999
Elliott J. Kennedy	55	Executive Vice President	1994
James L. Rose	45	Executive Vice President	2005
Peter R. Buchler	63	Executive Vice President, General Counsel and Secretary	2009

Code of Ethics

We have adopted a code of ethics for our chief executive, chief financial and principal accounting officers; a code of business conduct and ethics for members of our Board of Directors; and corporate governance guidelines. The full text of the codes of ethics and corporate governance guidelines is available at our website www.orionmarinegroup.com. Although we have never done so, in the event we make any amendment to, or grant any waiver from, a provision of the code of ethics that applies to the principal executive officer, principal financial officer or principal accounting officer that requires disclosure under applicable Commission rules, we will disclose such amendment or waiver and the reasons therefore on our website. We will provide any person without charge a copy of any of the aforementioned codes of ethics upon receipt of a written request. Requests should be addressed to: Orion Marine Group, Inc. 12000 Aerospace, Houston, Texas 77034, Attention: Corporate Secretary.

Corporate Governance

The information required by Items 407(c)(3), (d)(4) and (d)(5) of Regulation S-K is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year. The information required by Item 201(d) of Regulation S-K is submitted in a separate section of this Form 10-K. See Item 5. — Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities, above.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is hereby incorporated by reference from our definitive proxy statement to be filed with the SEC pursuant to Regulation 14A within 120 days after the close of our fiscal year.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this Report:

1. Financial Statements

The Company's Consolidated Financial Statements at December 31, 2008 and 2007 and for each of the three years in the period ended December 31, 2008 and the notes thereto, together with the Report of the Independent Registered Public Accounting Firm on those Consolidated Financial Statements are hereby filed as part of this Report, beginning on page F-1.

2. Financial Statement Schedule

The following financial statement schedule of the Company for each of the three years in the period ended December 31, 2009 is filed as part of this Report and should be read in conjunction with the Consolidated Financial Statements of the Company.

Schedule II – Schedule of Valuation and Qualifying Accounts

3. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Report. Except as noted below, all exhibits are incorporated by reference to the Company's Registration Statement on Form S-1 filed on August 20, 2007, as subsequently amended.

Exhibit Number		Description
1	.01	Form of Indemnity Agreement for Directors and Certain Officers dated November 24, 2008 (filed as Exhibit 1.01 to Form 8-K filed on November 25, 2008)
2	.1	Asset Purchase Agreement dated February 28, 2008, by and between OMGI Sub, LLC and Orion Marine Group, Inc. and Subaqueous Services, Inc. and Lance Young (filed as an exhibit to the Company's Current Report on Form 8-K on March 4, 2008)
2	.2	Purchase Agreement dated January 28, 2010 by and among LaQuay Holdings., Inc and Seagull Services Inc. (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K on February 2, 2010)
3	.1	Amended and Restated Certificate of Incorporation of Orion Marine Group, Inc.
3	.2	Amended and Restated Bylaws of Orion Marine Group, Inc.
4	.1	Registration Rights Agreement between Friedman, Billings, Ramsey & Co., Inc. and Orion Marine Group, Inc. dated May 17, 2007
10	.1	Loan Agreement, dated as of July 10, 2007, between Orion Marine Group, Inc. and Amegy Bank National Association

** 10	.1.1	First Amendment to Loan Agreement dated February 29, 2008, among Orion Marine Group, Inc., and Amegy Bank National Association, a national banking association, as agent
10	.2	Purchase/Placement Agreement dated May 9, 2007 between Orion Marine Group, Inc. and Friedman, Billings, Ramsey & Co., Inc.
10	.3	Amended & Restated Redemption Agreement dated May 7, 2007
+ 10	.8	2005 Stock Incentive Plan
+ 10	.9	Form of Stock Option Agreement Under the 2005 Stock Incentive Plan & Notice of Grant of Stock Option
+ 10	.10	Form of Restricted Stock Agreement Under the 2005 Stock Incentive Plan & Notice of Grant of Restricted Stock
+ 10	.11	Orion Marine Group, Inc. Long Term Incentive Plan
+ 10	.12	Form of Stock Option Agreement Under the 2007 Long Term Incentive Plan
+ 10	.13	Form of Restricted Stock Agreement and Notice of Grant of Restricted Stock
+ 10	.14	Executive Incentive Plan (filed as an exhibit to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008)
+ 10	.15	Subsidiary Incentive Plan (filed as an exhibit to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008)
+ 10	.16	Employment Agreement, dated as of December 4, 2009, by and between Orion Marine Group, Inc. and J. Michael Pearson
+ 10	.17	Employment Agreement, dated as of December 4, 2009, by and between Orion Marine Group, Inc. and Mark Stauffer
+ 10	.18	Employment Agreement , dated as of December 11, 2009, by and between Orion Marine Group, Inc. and Elliott Kennedy
+ 10	.19	Employment Agreement, dated as of December 11, 2009, by and between Orion Marine Group, Inc. and Jim Rose
+ 10	.20	Employment Agreement, dated as of December 11, 2009, by and between Orion Marine Group, Inc. and Peter R. Buchler
+ 10	.23	Schedule of Changes to Compensation of Non-employee Directors, effective for 2008 (filed as an exhibit to the Quarterly Report on Form 1-Q for the quarterly period ended June 30, 2008)
* 21	.1	List of Subsidiaries
* 23	.1	Consent of Independent Registered Public Accounting Firm
* 23	.2	Consent of Garland Sandhop, CPA
24	.1	Power of Attorney (included on signature page of this filing)
* 31	.1	Certification of CEO pursuant to Section 302
* 31	.2	Certification of CFO pursuant to Section 302
* 32	.1	Certification of CEO and CFO pursuant to Section 906
* 99	.1	Audited financial statements of T.W. LaQuay Dredging, LLC as of December 31, 2008
* 99	.2	Unaudited financial statements of T.W. LaQuay Dredging, LLC as of September 30, 2009
* 99	.3	Unaudited pro forma condensed combined balance sheet as of September 30, 2009 and statements of income for the year ended

December 31, 2008 and nine months ended September 30, 2009 of Orion Marine Group, Inc. and T.W. LaQuay Dredging, LLC

*	Filed herewith
**	Incorporated by reference to the Company's report on Form 8K filed with the SEC on March 4, 2008
+	Management contract or compensatory plan or arrangement
(b)	Financial Statement Schedules

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

ORION MARINE GROUP, INC.

Date: March 9, 2010   By: /s/ J. Michael Pearson
J. Michael Pearson
President and Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ J. Michael Pearson J. Michael Pearson	President and Chief Executive Officer and Director	March 9, 2010
/s/ Mark R. Stauffer Mark R. Stauffer	Chief Financial Officer Chief Accounting Officer	March 9, 2010
/s/ Richard L. Daerr, Jr. Richard L. Daerr, Jr.	Chairman of the Board	March 9, 2010
/s/ Thomas N. Amonett Thomas N. Amonett	Director	March 9, 2010
/s/ Austin J. Shanfelter Austin J. Shanfelter	Director	March 9, 2010
/s/ Gene Stoever Gene Stoever	Director	March 9, 2010

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ORION MARINE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

WITH REPORT OF INDEPENDENT REGISTERED ACCOUNTING FIRM

December 31, 2009

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ORION MARINE GROUP, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Orion Marine Group, Inc.

We have audited the accompanying consolidated balance sheets of Orion Marine Group, Inc. and subsidiaries at December 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Orion Marine Group, Inc. and subsidiaries at December 31, 2009 and 2008 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, the Company adopted new accounting guidance on January 1, 2009 related to the inclusion of certain instruments granted in share-based payment transactions in the calculation of basic earnings per common share.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Orion Marine Group, Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 9, 2010 expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ Grant Thornton LLP
Houston, Texas
March 9, 2010

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Orion Marine Group, Inc.

We have audited Orion Marine Group, Inc.'s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Orion Marine Group Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Orion Marine Group Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Orion Marine Group, Inc. has maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Orion Marine Group, Inc. and subsidiaries as of December 31, 2009 and 2008 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2009, and our report dated March 9, 2010 expressed an unqualified opinion on those consolidated financial statements.

/s/ GRANT THORNTON LLP
Houston, Texas

March 9, 2010

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ORION MARINE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2009 AND 2008
(In thousands, except share and per share amounts)

	December 31, 2009	2008
ASSETS		
Current assets:		
Cash and cash equivalents	$104,736	$25,712
Accounts receivable:		
Trade, net of allowance of $1,202 and $800, respectively	32,819	37,806
Retainage	12,028	5,719
Other	922	691
Income taxes receivable	3,040	4,017
Note receivable	961	--
Inventory	1,472	738
Deferred tax asset	1,499	1,319
Costs and estimated earnings in excess of billings on uncompleted contracts	10,868	7,228
Prepaid expenses and other	1,624	3,207
Total current assets	169,969	86,437
Property and equipment, net	90,790	84,154
Goodwill	12,096	12,096
Intangible assets, net of accumulated amortization	38	3,556
Other assets	264	79
Total assets	$273,157	$186,322
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$--	$5,909
Accounts payable:		
Trade	23,680	13,276
Retainage	1,227	389
Accrued liabilities	8,354	8,176
Taxes payable	312	--
Billings in excess of costs and estimated earnings on uncompleted contracts	5,636	11,666
Total current liabilities	39,209	39,416
Long-term debt, less current portion	--	28,216
Other long-term liabilities	514	422
Deferred income taxes	11,453	12,286
Deferred revenue	315	371
Total liabilities	51,491	80,711
Commitments and contingencies		
Stockholders' equity:		
Common stock -- $0.01 par value, 50,000,000 authorized, 26,852,407 and 21,577,366 issued; 26,840,761 and 21,565,720 outstanding at December 31, 2009 and 2008, respectively	268	216
Treasury stock, 11,646, at cost	--	--
Additional paid-in capital	151,361	55,388

Retained earnings	70,037	50,007
Total stockholders’ equity	221,666	105,611
Total liabilities and stockholders’ equity	$273,157	$186,322

The accompanying notes are an integral part of these consolidated financial statements

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ORION MARINE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except share and per share amounts)

	Year ended December 31,		
	2009	2008	2007
Contract revenues	$293,494	$261,802	$210,360
Costs of contract revenues	230,797	211,351	159,927
Gross profit	62,697	50,451	50,433
Selling, general and administrative expenses	30,947	27,978	22,946
	31,750	22,473	27,487
Interest (income) expense			
Interest (income)	(352)	(530)	(1,000)
Interest expense	538	1,246	910
Interest (income) expense, net	186	716	(90)
Income before income taxes	31,564	21,757	27,577
Income tax expense	11,534	7,282	10,178
Net income	$20,030	$14,475	$17,399
Net income	$20,030	$14,475	$17,399
Preferred dividends	--	--	782
Earnings available to common stockholders	$20,030	$14,475	$16,617
Earnings per share available to common stockholders:			
Basic	$0.85	$0.67	$0.85
Diluted	$0.84	$0.66	$0.83
Shares used to compute earnings per share			
Basic	23,577,854	21,561,201	19,657,436
Diluted	23,979,943	21,979,535	19,976,683

The accompanying notes are an integral part of these consolidated financial statements

ORION MARINE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(In thousands, except share information)

	Preferred stock Shares	Preferred stock Amount	Common stock Shares	Common stock Amount	Treasury stock Shares	Treasury stock Amount	Additional Paid-in capital	Retained earnings	Total
Balance, December 31, 2006	35,000	--	16,730,942	$167	(100,897)	$(24)	$34,963	$18,133	$53,239
Forfeit unvested restricted stock					(8,969)	--			--
Stock-based compensation							501		501
Liquidation of preferred stock	(35,000)	--					(40,431)		(40,431)
Exercise of stock options			22,422	--			48		48
Proceeds from sale of common stock, net of expenses			20,839,350	210	109,866	24	260,292		260,526
Redemption and cancellation of common shares			(16,053,816)	(161)			(201,394)		(201,555)
Issuance of common stock			26,426	--			357		357
Net income	--	-	--	--	--	--	--	17,399	17,399
Balance, December 31, 2007	--	$-	21,565,324	$216	--	$--	$54,336	$35,532	$90,084
Forfeit unvested restricted stock				--	(11,646)	--			--
Stock-based compensation							1,103		1,103
Expenses related to the							(51)		(51)

sale of common stock									
Issuance of restricted stock			12,042	--			--		--
Net income	--	-	--	--	--	--	--	14,475	14,475
Balance, December 31, 2008	--	$-	21,577,366	$216	(11,646)	$--	$55,388	$50,007	$105,611
Stock-based compensation							1,614		1,614
Exercise of stock options	--		382,852	$4			1,934		1,938
Excess tax benefits from exercise of stock options							1,476		1,476
Proceeds from sale of common stock, net of expenses			4,830,000	$ 48			90,949		90,997
Issuance of restricted stock			62,189						
Net income	--	-	--	--	--	--	--	20,030	20,030
Balance, December 31, 2009	--	-	26,852,407	$268	(11,646)	$--	$151,361	$70,037	$221,666

The accompanying notes are an integral part of this consolidated financial statement

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ORION MARINE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands, except share information)

	Year ended December 31,		
	2009	2008	2007
Cash flows from operating activities			
Net income	$20,030	$14,475	$17,399
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	18,536	18,599	12,384
Deferred financing cost amortization	252	249	208
Non-cash interest expense	--	22	86
Bad debt expense	442	300	--
Deferred income taxes	(1,013)	(2,410)	(1,998)
Stock-based compensation	1,614	1,103	858
Gain on sale of property and equipment	(518)	(1,075)	(333)
Excess tax benefit from stock option exercise	(1,476)	--	--
Change in operating assets and liabilities:			
Accounts receivable	(1,996)	(4,550)	(11,292)
Income tax receivable	2,453	(4,017)	--
Note receivable	(961)	--	--
Inventory	(734)	(92)	(120)
Prepaid expenses and other	1,608	(2,380)	(183)
Costs and estimated earnings in excess of billings on uncompleted contracts	(3,640)	1,678	(5,540)
Accounts payable	11,241	1,848	4,559
Accrued liabilities	270	661	(3,086)
Income tax payable	314	(1,960)	1,994
Billings in excess of costs and estimated earnings on uncompleted contracts	(6,030)	4,076	(4,790)
Deferred revenue	(56)	(56)	(54)
Net cash provided by operating activities	40,336	26,471	10,092
Cash flows from investing activities:			
Proceeds from sale of property and equipment	1,095	3,861	1,970
Purchase of property and equipment	(22,693)	(14,485)	(11,433)
Acquisition of business (net of cash acquired)	--	(36,713)	--
Net cash used in investing activities	(21,598)	(47,337)	(9,463)
Cash flows from financing activities:			
Increase in loan costs	--	(80)	(194)
Borrowings on long-term debt	--	35,000	--
Payments on long-term debt	(34,125)	(875)	(25,000)
Purchase of treasury stock	--	--	--
Exercise of stock options	1,938	--	48
Excess tax benefit from stock option exercise	1,476	--	--
Payment of accumulated preferred dividends and liquidation of preferred stock	--	--	(40,431)
Proceeds from the sale of common stock, net of offering costs	90,997	(51)	260,526
Redemption of common stock	--	--	(201,555)

Net cash provided by (used in) financing activities	60,286	33,994	(6,606)
Net change in cash and cash equivalents	79,024	13,128	(5,977)
Cash and cash equivalents at beginning of period	25,712	12,584	18,561
Cash and cash equivalents at end of period	$104,736	$25,712	$12,584
Supplemental disclosures of cash flow information:			
Cash paid during the period for:			
Interest	$553	$1,234	$927
Taxes, net of refunds	$9,781	$14,476	$9,835

The accompanying notes are an integral part of these consolidated financial statements

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ORION MARINE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2009, 2008 AND 2007
(Tabular Amounts in 000's, Except for Share and per Share Amounts)

1. Description of Business and Basis of Presentation

Description of Business

Orion Marine Group, Inc. and its subsidiaries (hereafter collectively referred to as "Orion" or the "Company") provide a broad range of marine construction services on, over and under the water along the Gulf Coast, the Atlantic Seaboard and the Caribbean Basin. Our heavy civil marine projects include marine transportation facilities; bridges and causeways; marine pipelines; mechanical and hydraulic dredging and specialty projects. We are headquartered in Houston, Texas.

Although we describe our business in this report in terms of the services we provide, our base of customers and the geographic areas in which we operate, we have concluded that our operations comprise one reportable segment pursuant to Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 280 – Segment Reporting. In making this determination, we considered that each project has similar characteristics, includes similar services, has similar types of customers and is subject to the same regulatory environment. We organize, evaluate and manage our financial information around each project when making operating decisions and assessing our overall performance.

Basis of Presentation

These consolidated financial statements include the accounts of the parent company, Orion Marine Group, Inc. and its wholly-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America. All significant intercompany balances and transactions have been eliminated in consolidation.

2. Summary of Accounting Principles

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Management's estimates, judgments and assumptions are continually evaluated based on available information and experience; however, actual amounts could differ from those estimates.

The Company's significant accounting policies that rely on the application of estimates and assumptions include:

- Revenue recognition from construction contracts;
- Allowance for doubtful accounts;
- Testing of goodwill and other long-lived assets for possible impairment;
- Income taxes;
- Self-insurance; and
- Stock-based compensation

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Revenue Recognition

The Company records revenue on construction contracts for financial statement purposes on the percentage-of-completion method, measured by the percentage of contract costs incurred to date to total estimated costs for each contract. This method is used because management considers contract costs incurred to be the best available measure of progress on these contracts. Contract revenue reflects the original contract price adjusted for agreed upon change orders. Contract costs include all direct costs, such as material and labor, and those indirect costs related to contract performance such as payroll taxes and insurance. General and administrative costs are charged to expense as incurred. Unapproved claims are recognized as an increase in contract revenue only when the collection is deemed probable and if the amount can be reasonably estimated for purposes of calculating total profit or loss on long-term contracts. Incentive fees, if available, are billed to the customer based on the terms and conditions of the contract. The Company records revenue and the unbilled receivable for claims to the extent of costs incurred and to the extent we believe related collection is probable and includes no profit on claims recorded. Changes in job performance, job conditions and estimated profitability, including those arising from final contract settlements, may result in revisions to costs and revenues and are recognized in the period in which the revisions are determined. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined, without regard to the percentage of completion. Revenue is recorded net of any sales taxes collected and paid on behalf of the customer, if applicable.

The current asset “costs and estimated earnings in excess of billings on uncompleted contracts” represents revenues recognized in excess of amounts billed to the customer, which management believes will be billed and collected within one year of the completion of the contract. The liability “billings in excess of costs and estimated earnings on uncompleted contracts” represents billings in advance of work performed.

The Company’s projects are typically short in duration, and usually span a period of three to nine months. Historically, we have not combined or segmented contracts.

Classification of Current Assets and Liabilities

The Company includes in current assets and liabilities amounts realizable and payable in the normal course of contract completion.

Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. At times, cash held by financial institutions may exceed federally insured limits. We have not historically sustained losses on our cash balances in excess of federally insured limits. Cash equivalents at December 31, 2009 and 2008 consisted primarily of money market mutual funds and overnight bank deposits.

Foreign Currencies

Historically, the Company’s exposure to foreign currency fluctuations has not been material and has been limited to temporary field accounts, located in countries where the Company performs work, which amounts were insignificant in either 2009 or 2008.

Risk Concentrations

Financial instruments that potentially subject the Company to concentrations of credit risk principally consist of cash and cash equivalents and accounts receivable.

The Company depends on its ability to continue to obtain federal, state and local governmental contracts, and indirectly, on the amount of funding available to these agencies for new and current governmental projects. Therefore, the Company's operations can be influenced by the level and timing of government funding. Statutory mechanics liens provide the Company high priority in the event of lien foreclosures following financial difficulties of private owners, thus minimizing credit risk with private customers.

The following table represents concentrations of receivables (trade and retainage) at December 31, 2009 and 2008:

	December 31, 2009		December 31, 2008	
	A/R	%	A/R	%
Federal Government………………….	$5,262	12 %	$1,593	4 %
State Governments……………………	1,124	3 %	3,866	9 %
Local Municipalities………………….	11,431	25 %	7,750	18 %
Private Companies……………………	27,030	60 %	30,316	69 %
	$44,847	100 %	$43,525	100 %

At December 31, 2009, one customer accounted for 12.3% of total receivables. At December 31, 2008, no single customer accounted for more than 10% of total receivables.

Accounts Receivable

Accounts receivable are stated at the historical carrying value, less write-offs and allowances for doubtful accounts. The Company has significant investments in billed and unbilled receivables as of December 31, 2009 and 2008. Billed receivables represent amounts billed upon the completion of small contracts and progress billings on large contracts in accordance with contract terms and milestones. Unbilled receivables on fixed-price contracts, which are included in costs in excess of billings, arise as revenues are recognized under the percentage-of-completion method. Unbilled amounts on cost-reimbursement contracts represent recoverable costs and accrued profits not yet billed. Revenue associated with these billings is recorded net of any sales tax, if applicable. In establishing an allowance for doubtful accounts, the Company evaluates its contract receivables and costs in excess of billings and thoroughly reviews historical collection experience, the financial condition of its customers, billing disputes and other factors. The Company writes off uncollectible accounts receivable against the allowance for doubtful accounts if it is determined that the amounts will not be collected or if a settlement is reached for an amount that is less than the carrying value.

At December 31, 2009 and 2008, the Company had an allowance for doubtful accounts of $1.2 million and $800,000 respectively. The increase in the allowance is related to a receivable on one project.

Balances billed to customers but not paid pursuant to retainage provisions in construction contracts generally become payable upon contract completion and acceptance by the owner. Retention at December 31, 2009 totaled $12.0 million, of which $1.8 million is expected to be collected beyond 2010. Retention at December 31, 2008 totaled $5.7 million.

The Company negotiates change orders and claims with its customers. Unsuccessful negotiations of claims could result in a change to contract revenue that is less than its carrying value, which could result in the recording of a loss. Successful claims negotiations could result in the recovery of previously recorded losses. Significant losses on receivables could adversely affect the Company's financial position, results of operations and overall liquidity.

Inventory

Inventory consists of parts and small equipment held for use in the ordinary course of business and is valued at the lower of cost or market using historical average cost. Where shipping and handling costs are incurred by us, these charges are included in inventory and charged to cost of contract revenue upon use.

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Property and Equipment

Property and equipment are recorded at cost. Ordinary maintenance and repairs that do not improve or extend the useful life of the asset are expensed as incurred. Major renewals and betterments of equipment are capitalized and depreciated generally over three to seven years until the next scheduled maintenance.

Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows:

Automobiles and trucks	3 to 5 years
Buildings and improvements	5 to 30 years
Construction equipment	3 to 15 years
Vessels and dredges	1 to 15 years
Office equipment	1 to 5 years

Dry-docking activities and costs are capitalized and amortized on the straight-line method over a period ranging from three to 15 years until the next scheduled dry-docking. Dry-docking activities include, but are not limited to, the inspection, refurbishment and replacement of steel, engine components, tailshafts, mooring equipment and other parts of the vessel. Amortization related to dry-docking activities is included as a component of depreciation. These activities and the related amortization periods are periodically reviewed to determine if the estimates are accurate. If warranted, a significant upgrade of equipment may result in a revision to the useful life of the asset, in which case, the change is accounted for prospectively.

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or the fair value, less the costs to sell, and are no longer depreciated. No property and equipment were held for sale at December 31, 2009 and December 31, 2008.

Goodwill and Other Intangible Assets

Goodwill

The Company has acquired businesses and assets in purchase transactions that resulted in the recognition of goodwill. Goodwill represents the costs in excess of fair values assigned to the underlying net assets in the acquisition. In accordance with US GAAP, acquired goodwill is not amortized, but is subject to impairment testing at least annually or more frequently if events or circumstances indicate that the asset more likely than not may be impaired.

The Company assesses the fair value of its reporting units based on a weighted average of valuations based on market multiples, discounted cash flows, and consideration of our market capitalization. The key assumptions used in the discounted cash flow valuations are discount rates and perpetual growth rates applied to cash flow projections. Also inherent in the discounted cash flow valuation models are past performance, projections and assumptions in current operating plans, and revenue growth rates over the next five years. These assumptions contemplate business, market and overall economic conditions. We also consider assumptions that market participants may use.

As required by the Company's policy, annual impairment tests of goodwill are performed during the fourth quarter of each year or when circumstances arise that indicate a possible impairment might exist. Based on this testing, the Company determined that goodwill was not impaired as of October 31, 2009, and no events have occurred since that date that would require an interim impairment test. The discount rate used in testing goodwill for impairment was 15.3%. Revenue growth was fixed at 5% per year, which was a conservative estimate based on economic and market conditions. As compared with the impairment test performed in 2008, the discount rate increased by 80 basis points, due to our assessment of economic conditions and risk while the revenue growth rate remained constant. This had the effect of reducing the indicated fair value in the 2009 test.

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Intangible assets

Intangible assets that have finite lives continue to be subject to amortization. In addition, the Company must evaluate the remaining useful life in each reporting period to determine whether events and circumstances warrant a revision of the remaining period of amortization. If the estimate of an intangible asset's remaining life is changed, the remaining carrying value of such asset is amortized prospectively over that revised remaining useful life.

Stock-Based Compensation

The Company recognizes compensation expense for equity awards over the vesting period based on the fair value of these awards at the date of grant. The computed fair value of these awards is recognized as a non-cash cost over the period the employee provides services, which is typically the vesting period of the award. The fair value of options granted is estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of restricted stock grants is equivalent to the fair value of the stock issued on the date of grant.

Compensation expense is recognized only for share-based payments expected to vest. The Company estimates forfeitures at the date of grant based on historical experience and future expectations. See Note 13 to the consolidated financial statements for further discussion of the Company's stock-based compensation plan.

Income Taxes

The Company determines its consolidated income tax provision using the asset and liability method prescribed by US GAAP, which requires the recognition of income tax expense for the amount of taxes payable or refundable for the current period and for deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. The Company must make significant assumptions, judgments and estimates to determine its current provision for income taxes, its deferred tax assets and liabilities, and any valuation allowance to be recorded against any deferred tax asset. The current provision for income tax is based upon the current tax laws and the Company's interpretation of these laws, as well as the probable outcomes of any tax audits. The value of any net deferred tax asset depends upon estimates of the amount and category of future taxable income reduced by the amount of any tax benefits that the Company does not expect to realize. Actual operating results and the underlying amount and category of income in future years could render current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate, thus impacting the Company's financial position and results of operations. The Company computes deferred income taxes using the liability method. Under the liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under the liability method, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company accounts for uncertain tax positions in accordance with the provisions of ASC 740-10, which it adopted on January 1, 2007, which prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken, or expected to be taken, on our consolidated tax return. We evaluate and record any uncertain tax positions based on the amount that management deems is more likely than not to be sustained upon examination and ultimate settlement with the tax authorities in the tax jurisdictions in which we operate.

Insurance Coverage

The Company maintains insurance coverage for its business and operations. Insurance related to property, equipment, automobile, general liability, and a portion of workers' compensation is provided through traditional policies, subject to a deductible. A portion of the Company's workers' compensation exposure is covered through a mutual association, which is subject to supplemental calls.

The Company maintains two levels of excess loss insurance coverage, $20 million in excess of primary coverage and $10 million in excess of the $20 million, which excess loss coverage responds to all of the Company's insurance policies other than a portion of its Workers' Compensation coverage and employee health care coverage. The Company's excess loss coverage responds to most of its policies when a primary limit of $1 million has been exhausted; provided that the primary limit for Maritime Employer's Liability is $10 million and the Watercraft Pollution Policy primary limit is $5 million.

Separately, the Company's employee health care is provided through a trust, administered by a third party. The Company funds the trust based on current claims. The administrator has purchased appropriate stop-loss coverage. Losses on these policies up to the deductible amounts are accrued based upon known claims incurred and an estimate to claims incurred but not reported. The accruals are derived from known facts, historical trends and industry averages to determine the best estimate of the ultimate expected loss. Actual claims may vary from our estimate. We include any adjustments to such reserves in our consolidated results of operations in the period in which they become known.

New Accounting Pronouncements

On July 1, 2009, the FASB officially launched the FASB ASC 105 -- Generally Accepted Accounting Principles, which established the FASB Accounting Standards Codification ("the Codification"), as the single official source of authoritative, nongovernmental, U.S. GAAP, in addition to guidance issued by the Securities and Exchange Commission. The Codification is designed to simplify U.S. GAAP into a single, topically ordered structure. All guidance contained in the Codification carries an equal level of authority. The Codification is effective for interim and annual periods ending after September 15, 2009. Accordingly, the Company refers to the Codification in respect of the appropriate accounting standards throughout this document as "FASB ASC". Implementation of the Codification did not have any impact on the Company's consolidated financial statements.

The Company accounts for business combinations in accordance with FASB ASC 805 -- Business Combinations, which is effective for business combinations for which the acquisition date is after January 1, 2009. Among other changes, ASC 805 requires acquisition related costs to be recognized separately from the acquisition; in addition, in a business combination achieved in stages, an acquirer is required to recognize identifiable assets, liabilities and non-controlling interests in the aquiree at the full amounts of their fair values as of the acquisition date; and an acquirer is required to recognize assets or liabilities from contingencies as of the acquisition date.

The Company adopted the provisions of FASB ASC 260 -- Earnings Per Share, effective January 1, 2009, which required that all unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, be included in the basic Earnings Per Share (EPS) calculation. Prior-year basic weighted average shares outstanding numbers have been adjusted retrospectively on a consistent basis with 2009 reporting. This standard did not affect earnings per share for any period presented.

The Company accounts for its intangible assets under the provisions of FASB ASC 350 -- Intangibles – Goodwill and Other, and, effective January 1, 2009, adopted provisions within that topic that clarify accounting for defensive intangible assets subsequent to initial measurement, and applies to acquired intangible assets which an entity has no intention of actively using, or intends to discontinue use of, the intangible asset but holds it to prevent others from obtaining access to it (i.e., a defensive intangible asset). Also effective January 1, 2009, the Company adopted provisions within FASB ASC 350 that amend the factors considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset, which requires a consistent approach between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of an asset. Adoption of these provisions did not have a material impact on the Company's consolidated results of operations or financial condition for 2009. The Company is evaluating the impact of this pronouncement for 2010 based on its recent acquisitions.

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3. Offering of Common Stock

2007 Common Stock Offering
In May, 2007, the Company completed the sale of 20,949,216 shares of its common stock (the "Transaction"). Immediately prior to the sale of the common stock, the Company's certificate of incorporation was amended whereby all Class A common stock was converted into preferred stock and the Class B common stock was converted into common stock and each 2.23 outstanding shares of common stock was combined into one outstanding share of common stock.
In connection with the Transaction, the Company entered into employment agreements and transaction bonus agreements with its executive officers and certain key employees. Under the agreements, the Company granted 26,426 shares of common stock, granted options to acquire 327,357 shares of common stock, and made cash payments totaling $2.2 million. In addition, the Company granted options to acquire 26,904 shares of common stock to its independent directors.

From the sale of its common stock in the Transaction, the Company received net proceeds of approximately $260.5 million and used approximately $242.0 million to purchase and retire all of the outstanding preferred stock and 16,053,816 shares of common stock from its former principal stockholders.

Pursuant to an agreement entered into at the end of March 2007, an employee who participated in the Transaction agreed to accelerate the vesting of his restricted stock and forfeit unvested stock options. The agreement also provided that these shares would be redeemed in the Transaction but that the Company would hold the proceeds until the end of the term of his employment agreement (July 31, 2007). The proceeds were paid on July 31, 2007.

2009 Common Stock Offering
In August 2009, pursuant to a shelf registration statement on Form S-3, the Company completed a public offering of 4,830,000 shares of its common stock at $19.70 per share. The Company received proceeds, net of underwriting commissions, of $91.3 million ($18.91 per share), and paid approximately $524,000 in related offering expenses. The underwriters contributed $200,000 to offset a portion of the Company's expenses. A portion of the offering proceeds was used to repay the Company's outstanding debt of approximately $29.9 million.

Proceeds received from the sale of securities	$95,151	
Less:		
Underwriters' commission	(3,806	)
	91,345	
Offering related expenses	(548	)
Expense credit received from underwriters	200	
Total proceeds, net of expenses	$90,997	
Use of proceeds:		
Purchase of specialized equipment	5,778	
Repayment of outstanding debt	29,966	
Balance retained in working capital, December 31, 2009	$55,253	

The remaining proceeds, along with other cash on hand was used to fund the acquisitions discussed in Note 22, below.

4. Business Acquisitions

In February 2008, the Company purchased substantially all of the assets (with the exception of working capital) and related business (principally consisting of project contracts) of Orlando, Florida-based Subaqueous Services, Inc., a Florida corporation ("SSI") for approximately $36.7 million in cash.

The Company funded the acquisition using cash on hand, its acquisition line of $25 million and a draw on its accordion facility of $10 million.

5. Inventory

Inventory at December 31, 2009 and December 31, 2008, of $1.5 million and $738,000, respectively, consists of parts and small equipment held for use in the ordinary course of business.

6. Fair Value of Financial Instruments

The fair value of financial instruments is the amount at which the instrument could be exchanged in a current transaction between willing parties. Due to their short term nature, we believe that the carrying value of our accounts receivables, other current assets, accounts payables and other current liabilities approximate their fair values. We have a note receivable in the amount of $961,000 from a customer providing for payments over a ten month period. Due to the short-term payment schedule, we believe that the carrying value of the note receivable approximates its fair value.

7. Contracts in Progress

Contracts in progress are as follows at December 31, 2009 and December 31, 2008:

	2009	2008
Costs incurred on uncompleted contracts……………………………..........	$235,175	$196,363
Estimated earnings………………………………………………………	61,486	54,711
	296,661	251,074
Less: Billings to date…………………………………………………...	(291,429)	(255,512)
	$5,232	$(4,438)
Included in the accompanying consolidated balance sheet under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts.	$10,868	$7,228
Billings in excess of costs and estimated earnings on uncompleted contracts.	(5,636)	(11,666)
	$5,232	$(4,438)

Contract costs include all direct costs, such as material and labor, and those indirect costs related to contract performance such as payroll taxes, insurance, job supervision and equipment charges. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability may result in revisions to costs and income and are recognized in the period in which the revisions are determined. An amount equal to contract costs attributable to claims is included in revenues when realization is probable and the amount can be reliably estimated.

8. Property and Equipment

The following is a summary of property and equipment at December 31, 2009 and December 31, 2008:

	2009	2008
Automobiles and trucks……………………	$1,409	$1,472
Building and improvements………………..	12,832	12,015
Construction equipment……………………	92,230	88,070
Dredges and dredging equipment…………	44,912	42,458
Office equipment…………………………...	2,460	1,123
	153,843	145,138
Less: accumulated depreciation…………...	(82,671)	(69,092)
Net book value of depreciable assets………	71,172	76,046
Construction in progress…………………...	14,389	2,886
Land………………………………………..	5,229	5,222
	$90,790	$84,154

For the years ended December 31, 2009, 2008 and 2007 depreciation expense was $15.5 million, $14.7 million, and $12.4 million, respectively. The assets of the Company are pledged as collateral for the Company's line of credit.

9. Non-monetary transaction

During the first quarter of 2009, the Company entered into a non-monetary exchange with an unrelated party, whereby the Company would provide marine construction services, including dredging and sheet pile work in exchange for delivery of seven new pushboats to add to the Company's fleet. The total value of the work contracted and the fair value of the boats, when delivered to the Company, is approximately $1.8 million. At December 31, 2009, the Company had performed work with a value of approximately $1.3 million, and had taken delivery of all seven pushboats, and is expected to complete the remaining work early in 2010.

10. Goodwill

The table below summarizes activity related to goodwill as of December 31, 2009 and 2008:

	2009	2008
Beginning balance, January 1……………...	$12,096	$2,481
Additions…………………………………...	--	9,615
Impairment…………………………………	--	--
Ending balance, December 31……………..	$12,096	$12,096

11. Intangible assets

The tables below present the activity and amortizations of finite-lived intangible assets

	2009
Intangible assets, January 1, 2009………	$6,900
Additions………………………………….	--
Total intangible assets……………………	6,900

Accumulated amortization………………..	$(3,806)
Current year amortization…………………	(3,056)
Total accumulated amortization…………..	(6,862)
Net intangible assets, end of year………..	$38

The Company's finite-lived intangible assets are estimated to be amortized as follows:

Year Ended December 31,	
2010	$33
2011	$5

12. Accrued Liabilities

Accrued liabilities at December 31, 2009 and 2008 consisted of the following:

	2009	2008
Accrued salaries, wages and benefits………	$5,195	$3,856
Accrual for self-insurance liabilities……….	2,114	2,143
Other accrued expenses…………………….	1,045	2,177
	$8,354	$8,176

13. Long-term Debt and Line of Credit

The Company has a credit facility with several participating banks. In February 2008, the Company borrowed $35 million to fund the purchase of the assets of SSI. In August 2009, the Company repaid the outstanding balance on the credit facility of $29.9 million from proceeds received from its common stock offering (Note 3, above). The Company has available to borrow up to $15 million under an acquisition term loan facility and up to $8.5 million under a revolving line of credit. All provisions under the credit facility mature on September 30, 2010.

The revolving line of credit is subject to a borrowing base and availability on the revolving line of credit is reduced by any outstanding letters of credit. At December 31, 2009, the Company had outstanding letters of credit of $910,000, thus reducing the balance available to the Company on the revolving line of credit to approximately $7.6 million. The Company is subject to a monthly commitment fee on the unused portion of the revolving line of credit at a current rate of 0.20% of the unused balance. As of December 31, 2009, no amounts had been drawn under the revolving line of credit.

The credit facility is secured by the bank accounts, accounts receivable, inventory, equipment and other assets of the Company and its subsidiaries and places restrictions on the Company as to its ability to incur additional debt, pay dividends, advance loans, and engage in other actions. The credit facility also requires the Company to maintain certain financial ratios as follows:

- A minimum net worth in the amount of not less than the sum of $40.0 million plus 50% of consolidated net income earned in each fiscal quarter ended after December 31, 2006 plus adjustments for certain equity transactions;
- A minimum fixed charge coverage ratio of not less than 1.30 to 1.0 as of each fiscal quarter end; and
- A total leverage ratio not greater than 3.0 to 1.0 as of each fiscal quarter end.

At December 31, 2009, the Company was in compliance with all its financial covenants with a sufficient margin as to not impair its ability to incur additional debt or violate the terms of its credit facility. Historically, the Company has not relied on debt financing to fund its operations or working capital.

The Company is in negotiations to renew its credit facility prior to the September 30, 2010 expiration.

14. Stockholders' Equity

Common Stock

Prior to May 2007, the Company had a capital structure consisting of Class A and Class B Common stock. The Class A stock was entitled to receive cumulative dividends at the annual rate of 6 percent of the original issue price. On May 17, 2007, the Company converted all Class A stock into preferred, redeemed all Class A stock and paid all outstanding dividends totaling $5.4 million. Upon redemption the preferred stock was retired. The Class B common stock was converted into common stock and was subject to a 1 for 2.23 exchange of outstanding shares. Common stockholders are entitled to vote and to receive dividends if declared.

In August 2009, pursuant to a shelf registration statement on Form S-3, the Company completed a public offering of 4,830,000 shares of its common stock at $19.70 per share. The Company received proceeds, net of underwriting commissions, of $91.3 million ($18.91 per share), and paid approximately $524,000 in related offering expenses.

15. Stock-Based Compensation

The Compensation Committee of the Company's Board of Directors is responsible for the administration of the Company's two stock incentive plans (the "LTIP" and the "2005 Plan"). In general, the plans provide for grants of restricted stock and stock options to be issued with a per-share price equal to the fair market value of a share of common stock on the date of grant. Option terms are specified at each grant date, but generally are 10 years. Options generally vest over a three to five year period. Total shares of common stock that may be delivered under the LTIP and the 2005 Plan may not exceed 2,943,946.

Restricted Stock

The following table summarizes the restricted stock activity under the 2005 Plan and LTIP:

	Number of Shares	Weighted Average Fair Value Per Share
Nonvested at December 31, 2006…………………	604,708	$0.02
Granted……………………………………………..	26,426	$13.50
Vested………………………………………………	(520,142)	$0.71
Forfeited/repurchased shares………………………..	(8,969)	$0.02
Nonvested at December 31, 2007…………………..	102,023	$0.02
Granted……………………………………………...	12,042	$8.72
Vested……………………………………………….	(38,132)	$0.02
Forfeited/repurchased shares………………………..	(11,646)	$0.02
Nonvested at December 31, 2008…………………..	64,287	$1.65
Granted……………………………………………...	62,189	$19.01
Vested……………………………………………….	(36,771)	$0.02
Forfeited/repurchased shares………………………..	--	--
Nonvested at December 31, 2009	89,705	$14.36

In May 2007, 26,426 shares of fully vested stock were granted to certain employees of the Company upon completion of the Transaction. Compensation related to this grant of fully vested shares in May 2007 totaled approximately $357,000.

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As part of their 2008 and 2009 compensation packages, the independent directors each received an equity award of either restricted stock or options with a fair value on the date of grant of $35,000. In December 2008, and in June 2009, three directors elected to receive stock, which is restricted from sale in total for a period of three years from the date of grant. One director elected to receive options, which is also restricted from exercise for a period of three years and is included in the discussion of stock options below. Compensation related to the grants of restricted stock totaled $105,000 in each of 2009 and 2008 and is expensed ratably over the three-year vesting period.

Changes to the independent director compensation plan, approved in November 2009, resulted in equity compensation granted to each of the independent directors with a fair value of $60,000, with vesting in six months from the date of grant. Also in November 2009, the Compensation Committee of the Board of Directors approved grants of stock to its named executive officers, with vesting over a three year period.

Stock Options

The following table summarizes the stock option activity under the 2005 Plan and LTIP:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2006…………………	443,959	$1.96		
Granted…………………………………………...	579,261	$13.79		
Exercised………………………………………….	(22,422)	$1.96		
Forfeited…………………………………………...	(98,654)	$3.00		
Outstanding at December 31, 2007…………………	902,144			
Granted…………………………………………...	451,749	$6.48		
Exercised………………………………………….	--	--		
Forfeited………………………………………...	(25,553)	$13.65		
Outstanding at December 31, 2008…………………	1,328,340	$8.35		
Granted…………………………………………...	262,934	$19.19		
Exercised………………………………………….	(382,852)	$5.06		
Forfeited………………………………………...	(22,102)	$11.27		
Outstanding at December 31, 2009…………………	1,186,320	$11.76		
Vested at December 31, 2009 and expected to vest....	1,130,085	$11.76	8.47	$10,508
Exercisable at December 31, 2009…………………..	521,279	$10.91	7.88	$5,292

As part of the Transaction in May 2007, 89,686 options were forfeited, 22,422 were exercised and vesting was accelerated on 165,078 options, for additional compensation costs of $140,000.

The Company calculates the fair value of each option on the date of grant using the Black-Scholes pricing model and the following weighted-average assumptions in each year:

	2009	2008	2007
Weighted average grant-date fair value of options granted	$8.57	$2.52	$5.35
Risk-free interest rate	1.3%	2.9%	4.3%

Expected volatility	66.5 %	37 %	31 %
Expected term of options (in years)	3.0	6.0	6.0
Dividend yield	0 %	0 %	0 %

The risk-free interest rate is based on interest rates on U.S. Treasury zero-coupon issues that match the contractual terms of the stock option grants. The expected term represents the period in which the Company's equity awards are expected to be outstanding, which for 2009 is based on the exercise history.

For 2008 and 2007, the expected term was calculated using the "simplified method" as the Company did not have sufficient information regarding historical exercise behavior to accurately estimate the expected term. For grants made in 2009, volatility was calculated based on the Company's historic stock price. Volatility was calculated using an average of similar public companies within the Company's industry in 2008 and 2007, as the Company did not have sufficient data to accurately estimate volatility of its common stock. The Company does not anticipate paying dividends in the future.

Compensation expense related to equity award grants totaled $1.6 million, $1.1 million, and $858,000 for the years ended December 31, 2009, 2008 and 2007, respectively.

As of December 31, 2009, there was $4.4 million of unrecognized compensation cost, net of estimated forfeitures, related to the Company's non-vested equity awards, which is expected to be recognized over a weighted average period of 1.4 years.

	2009	2008	2007
Total intrinsic value of options exercised	$5,042	$----	$258
Total fair value of shares vested	$6,367	$1,282	$4,007

16. Income Taxes

The following table presents the components of our consolidated income tax expense for each fiscal year ended December 31:

	Current	Deferred	Total
2009			
U.S. Federal	$11,484	$(392)	$11,092
State and local	1,063	(621)	442
	$12,547	$(1,013)	$11,534
2008			
U.S. Federal	$9,090	$(2,403)	$6,687
State and local	602	(7)	595
	$9,692	$(2,410)	$7,282
2007			
U.S. Federal	$11,577	$(1,392)	$10,185
State and local	599	(606)	(7)
	$12,176	$(1,998)	$10,178

The Company's income tax provision reconciles to the provision at the statutory U.S. federal income tax rate for each year ended December 31 as follows:

	2009	2008	2007
Statutory amount (computed at 35%)………..	$11,048	$7,615	$9,652
State income tax, net of federal benefit……...	290	385	(5)
Permanent differences………………………	5	(86)	(101)
Other (net)………………………………...	191	(632)	632
Consolidated income tax provision…………	$11,534	$7,282	$10,178
Consolidated effective tax rate………………	36.5%	33.5%	36.9%

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The Company's deferred tax (assets) liabilities are as follows:

	December 31, 2009		December 31, 2008	
	Current	Long-term	Current	Long-term
Assets related to:				
Accrued liabilities………………………………………	$837	$--	$738	$--
Intangible assets………………………………………		2,814		1,771
Allowance for bad debt……………………………….	421		280	
Non-qualified stock options…………………………….		72		32
Other………………………………………………….	241	731	301	21
Total assets……………………………………………	1,499	3,617	1,319	1,824
Liabilities related to:				
Depreciation and amortization…………………………..		(15,003)		(14,098)
Other………………………………………………….	--	(67)	--	(12)
Total liabilities………………………………………..	--	(15,070)	--	(14,110)
Net deferred assets (liabilities)…………………………..	$1,499	$(11,453)	$1,319	$(12,286)

As reported in the balance sheet:

	December 31, 2009	December 31, 2008
As reported in the balance sheet:		
Net current deferred tax assets	1,499	1,319
Net non-current deferred tax liabilities	(11,453)	(12,286)
Total net deferred tax liabilities:	$(9,554)	$ (10,967)

In assessing the realizability of deferred tax assets at December 31, 2009, the Company considered whether it was more likely than not that some portion or all of the deferred tax assets will not be realized. The realization of deferred tax assets depends upon the generation of future taxable income during the periods in which these temporary differences become deductible. As of December 31, 2009, the Company believes that all of the deferred tax assets will be utilized and therefore has not recorded a valuation allowance.

Although the Company believes its recorded assets and liabilities are reasonable, tax regulations are subject to interpretation and tax litigation is inherently uncertain; therefore the Company's assessments can involve both a series of complex judgments about future events and rely heavily on estimates and assumptions. Although the Company believes that the estimates and assumptions supporting its assessments are reasonable, the final determination of tax audit settlements and any related litigation could be materially different from that which is reflected in historical income tax provisions and recorded assets and liabilities. If the Company were to settle an audit or a matter under litigation, it could have a material effect on the income tax provision, net income, or cash flows in the period or periods for which that determination is made. Any accruals for tax contingencies are provided for in accordance with US GAAP.

The Company believes that it has no uncertain tax positions. The Company does not believe that its tax positions will significantly change due to the settlement and expiration of statutes of limitations prior to December 31, 2010.

The Company and its subsidiaries file income tax returns in the United States federal jurisdiction and in various states. With few exceptions, the Company remains subject to federal and state income tax examinations for the years of 2006, 2007, 2008 and 2009. The Company's policy is to recognize interest and penalties related to any unrecognized tax liabilities as additional tax expense. No interest or penalties have been accrued at December 31, 2009 and 2008, as the Company has not recorded any uncertain tax positions. The Company believes it has appropriate and adequate support for the income tax positions taken and to be taken on its tax returns and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter.

17. Earnings Per Share

On January 1, 2009, the Company adopted changes issued by the FASB to the calculation of earnings per share. These changes state that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method for all periods presented. Under our stock-based compensation programs, certain employees are granted stock and performance awards, which entitle those employees to receive nonforfeitable dividends during the vesting period on a basis equivalent to any dividends paid to holders of the Company's common stock. As such, these unvested stock and performance awards meet the definition of a participating security. Under the two-class method, all earnings, whether distributed or undistributed, are allocated to each class of common stock and participating securities based on their respective rights to receive dividends. Prior to the adoption of these changes, stock and performance awards were considered potential shares of common stock and were included only in the diluted EPS calculation under the treasury stock method as long as their effect was not anti-dilutive. Weighted average shares outstanding data for prior periods presented were revised to reflect these changes, which did not affect earnings per share in any period presented.

Basic earnings per share are based on the weighted average number of common shares outstanding during each period. Diluted earnings per share are based on the weighted average number of common shares outstanding and the effect of all dilutive common stock equivalents during each period. In April 2007, the Company authorized a 2.23 for one reverse split of the then Class B common shares, which became effective upon the closing of the Transaction at which time the Company's certificate of incorporation was modified such that Class A shares were converted into preferred and Class B shares were converted into common shares. Computations of basic and diluted earnings per share have been adjusted retroactively for all periods presented to reflect the common stock split. At December 31, 2009, 2008 and 2007, 262,934, 996,489 and 570,293 common stock equivalents, respectively, were not included in the diluted earnings per share calculation, as the effect of these shares would have been anti-dilutive.

In May 2007, all outstanding preferred (Class A) dividends were paid in full and these shares were redeemed and retired.

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The following table reconciles the numerators and denominators used in the computations of both basic and diluted EPS for each fiscal year ended December 31:

	2009	2008	2007
Basic EPS computation:			
Numerator:			
Net income………………………………………	$ 20,030	$ 14,475	$17,399
Preferred dividends…………………………………	--	--	782
Earnings available to common stockholders………	$ 20,030	$ 14,475	$16,617
Denominator:			
Basic weighted average shares outstanding,…………	23,577,854	21,561,201	19,657,436
Basic earnings per share……………………………	$ 0.85	$ 0.67	$0.85
Diluted EPS computation:			
Total basic weighted average shares outstanding……	23,577,854	21,561,201	19,657,436
Effect of dilutive securities:			
Common stock options……………………………	402,088	418,334	319,247
Total weighted average shares outstanding assuming dilution	23,979,943	21,979,535	19,976,683
Diluted earnings per share…………………………	$ 0.84	$ 0.83	$0.83

(1) Upon any liquidation of the Company, holders of preferred shares would have received a liquidation preference of $1,000 per share, plus 6% cumulative dividends per year. Holders were not entitled to additional payment or distribution of the earnings, assets or surplus funds of the Company upon liquidation. The shares were converted into preferred stock, redeemed and retired in May 2007. See Note 19.

18. Enterprise Wide Disclosures

The Company is a heavy civil contractor specializing in marine construction. The Company operates as a single segment, as each project has similar characteristics, includes similar services, has similar types of customers and is subject to the same regulatory environment. The Company organizes and evaluates its financial information around each project when making operating decisions and assessing its overall performance.

The Company's primary customers are governmental agencies in the United States. The following table represents concentrations of revenue by type of customer for the years ended December 31, 2009, 2008, and 2007.

	2009	%	2008	%	2007	%
Federal……..	$54,173	19 %	$29,134	11 %	$37,528	18 %
State………..	24,835	8 %	37,340	14 %	13,489	6 %
Local……….	82,933	28 %	64,713	25 %	69,235	33 %
Private………	131,553	45 %	130,615	50 %	90,108	43 %
	$293,494	100 %	$261,802	100 %	$210,360	100 %

Revenues generated outside the United States totaled 14%, 7.0%, and 4.0% of total revenues for the years ended 2009, 2008 and 2007, respectively. Revenue generated outside the United States in 2009 was primarily related to construction of a cruise pier and facilities in Haiti.

The Company's long-lived assets are substantially located in the United States.

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Significant customers

The following customers accounted for 10% or more of contract revenues for the years ended December 31, 2009, 2008 and 2007:

	2009		2008		2007	
Customer A	N/A		N/A		13	%
Customer B	16	%	N/A		12	%
Customer C	N/A		10	%	N/A	

19. Employee Benefits

All employees except the Associate Divers and Associate Tugmasters are eligible to participate in the Company's 401(k) Retirement Plan after completing six months of service. Each participant may contribute between 1% and 80% of eligible compensation on a pretax basis, up to the annual IRS limit. The Company matches 100% on the first 2% of eligible compensation contributed to the Plan and 50% on the next 2% of eligible compensation contributed to the Plan. Participants' contributions are fully vested at all times. Employer matching contributions vest over a four-year period. At its discretion, the Company may make additional matching and profit-sharing contributions. During the years ended December 31, 2009, 2008 and 2007, the Company contributed $1.0 million, $0.9 million, and $0.8 million, to the plan.

20 Commitments and Contingencies

Operating Leases

In July 2005, the Company executed a sale-leaseback transaction in which it sold an office building for $2.1 million and entered into a ten year lease agreement. The Company, at its option, can extend the lease for two additional five year terms. Scheduled increases in monthly rent are included in the lease agreement.

The sale of the office building resulted in a gain of $562,000 which has been deferred and amortized over the life of the lease. The Company recognized $54,212 in each of the years ending December 31, 2009, 2008 and 2007, respectively. Rent expense under this agreement was $168,504, $168,162 and $164,400 for each of the years ending December 31, 2009, 2008 and 2007, respectively.

In 2005, the Company entered into a lease agreement for vehicles under a continuing operating lease agreement. Rental expense under this lease for the years ended December 31, 2009, 2008 and 2007 was $2.1 million, $1.4 million, and $951,000, respectively.

The Company leases its corporate office in Houston, Texas under a lease with an initial term of nine years. In addition, the Company leases other facilities, including office space and yard facilities, under terms that range from one to five years. The Company also leases short-term field office space at its various construction sites for the duration of the projects.

Future minimum lease payments under non-cancelable operating leases as of December 31, 2009 are as follows:

		Amount
Year ended December 31,		
2010……………………	$……………………	2,981

2011…………………………………………		2,229
2012…………………………………………		1,248
2013…………………………………………		669
2014…………………………………………		512
Thereafter…………………………………...		514
	$	8,153

Litigation
From time to time the Company is a party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of business. These actions typically seek, among other things, compensation for alleged personal injury, breach of contract, property damage, punitive damages, civil penalties or other losses, or injunctive or declaratory relief. With respect to such lawsuits, the Company accrues reserves when it is probable a liability has been incurred and the amount of loss can be reasonably estimated. The Company does not believe any of these proceedings, individually or in the aggregate, would be expected to have a material adverse effect on results of operations, cash flows or financial condition.

The Company was named as one of a substantial number of defendants in numerous individual claims and lawsuits brought by the residents and landowners of New Orleans, Louisiana and surrounding areas in the United States District Court for the Eastern District of Louisiana. These suits have been classified as a subcategory of suits under the more expansive proceeding, In re Canal Breaches Consolidation Litigation, Civil Action No: 05-4182, (E.D. La,), which was instituted in late 2005. While not technically class actions, the individual claims and lawsuits are being prosecuted in a manner similar to that employed for federal class actions. The claims are based on flooding and related damage from Hurricane Katrina. In general, the claimants state that the flooding and related damage resulted from the failure of certain aspects of the levee system constructed by the Corps of Engineers, and the claimants seek recovery of alleged general and special damages. The Corps of Engineers has contracted with various private dredging companies, including us, to perform maintenance dredging of the waterways. In accordance with a decision (In re Canal Breaches Consolidation Litigation, Civil Action No: 05-4182, "Order and Reasons," March 9, 2007 (E.D. La, 2007)), we believe that we have no liability under these claims unless we deviated from our contracted scope of work on a project. In June of 2007, however, the plaintiffs filed two separate appeals of this decision to the United States Court of Appeals for the Fifth Circuit, where on November 25, 2009 a portion of the decision of the trial court was affirmed. The other portion, for claims in Limitation Actions, remains pending.

21. Subsidiary Guarantors

The Company filed a registration statement on Form S−3 which became effective August 7, 2009, and registered certain securities described therein, including debt securities, which may be guaranteed by certain of the Company’s subsidiaries and are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933. Orion Marine Group, Inc., as the parent company, has no independent assets or operations. The Company contemplates that if it offers guaranteed debt securities pursuant to the registration statement, all guarantees will be full and unconditional and joint and several, and any subsidiaries of the Company other than the subsidiary guarantors will be minor. In addition, there are no restrictions on the ability of Orion Marine Group, Inc. to obtain funds from its subsidiaries by dividend or loan. Finally, there are no restricted assets in any subsidiaries.

22. Subsequent events

On January 28, 2010, Seagull Services, LLC, a wholly-owned subsidiary of the Company purchased (a) the membership interests of T.W. LaQuay Dredging, LLC (“TWLD”), a Texas limited liability company, from LaQuay Holdings, Inc. (the “Seller”), (b) all of the issued and outstanding capital stock of Industrial Channel and Dock, Company, a Texas Corporation, and Commercial Channel and Dock Company, a Texas Corporation (collectively, the “Channel and Dock Companies”), from Timothy W. LaQuay and Linda F. LaQuay (the principal shareholders of the Seller, the “Principal Shareholders”), and (c) certain parcels of real property located in Calhoun County, Port Lavaca, Texas from the Principal Shareholders (collectively, the “Purchase Transactions”). At the closing, the Company entered into a consulting agreement with Timothy and Linda LaQuay and with Charles F. Barnett for a term of one year from the Closing Date.

Upon the terms of and subject to the conditions set forth in the Purchase Agreement, the total aggregate consideration paid by the Company to the Seller and the Principal Shareholders consisted of the following:

- Cash consideration of $55.5 million, paid to the Seller for the membership interests of T.W. LaQuay Dredging;
- Cash consideration of $4.5 million, paid to the Principal Shareholders for the Channel and Dock Companies and the above mentioned parcels of land; and
- Up to an additional $4.0 million (to be held in escrow) payable to Seller as a result of an increase in the purchase price of the membership interests by the amount of any additional taxes incurred by the Seller arising from the allocation of the membership interests purchase price, as further described in Section 1060 of the U.S. Internal Revenue Code, as amended.

The Purchase Agreement contains customary representations, warranties, covenants and indemnities, including certain post-closing covenants with respect to confidentiality and non-competition.

The following table summarizes the preliminary allocation of the purchase price:

Fair value of working capital items	$ 4,007
Property and equipment	$48,594
Goodwill	$11,399
Total	$64,000

The purchase price has been allocated to the assets acquired and the liabilities assumed using estimated fair values as of the acquisition date. The estimates and assumptions are subject to change upon the finalization of valuations, which are contingent upon final appraisals of property and equipment, identifiable intangible assets, and other adjustments through January 28, 2010. Revisions to the preliminary purchase price allocation could result in significant deviations from the preliminary allocation.

The following unaudited pro forma condensed combined financial information presents how results of operations may have appeared had the acquisition occurred on January 1, 2008:

	2009	2008
Revenues	$334,271	$284,190
Income before taxes	39,206	22,851
Net income	$24,879	$15,203
Diluted net income per share available to common stockholders	$1.04	$0.69

On February 11, 2010, the Company purchased several heavy civil marine construction equipment items including derrick barges, cranes, hammers and ancillary equipment from a private company exiting the marine construction business, for a purchase price of approximately $7.0 million. The Company intends to establish a base to serve the Pacific Northwest and West Coast, through the lease of yard and office space in Tacoma, Washington. The Company is currently determining the fair value of the assets acquired.

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EXHIBIT INDEX

Exhibit Number		Description
1	.01	Form of Indemnity Agreement for Directors and Certain Officers dated November 24, 2008 (filed as Exhibit 1.01 to Form 8-K filed on November 25, 2008)
2	.1	Asset Purchase Agreement dated February 28, 2008, by and between OMGI Sub, LLC and Orion Marine Group, Inc. and Subaqueous Services, Inc. and Lance Young (filed as an exhibit to the Company's Current Report on Form 8-K on March 4, 2008)
2	.2	Purchase Agreement dated January 28, 2010 by and among LaQuay Holdings., Inc and Seagull Services Inc. (filed as Exhibit 2.1 to the Company's Current Report on Form 8-K on February 2, 2010)
3	.1	Amended and Restated Certificate of Incorporation of Orion Marine Group, Inc.
3	.2	Amended and Restated Bylaws of Orion Marine Group, Inc.
4	.1	Registration Rights Agreement between Friedman, Billings, Ramsey & Co., Inc. and Orion Marine Group, Inc. dated May 17, 2007
10	.1	Loan Agreement, dated as of July 10, 2007, between Orion Marine Group, Inc. and Amegy Bank National Association
** 10	.1.1	First Amendment to Loan Agreement dated February 29, 2008, among Orion Marine Group, Inc., and Amegy Bank National Association, a national banking association, as agent
10	.2	Purchase/Placement Agreement dated May 9, 2007 between Orion Marine Group, Inc. and Friedman, Billings, Ramsey & Co., Inc.
10	.3	Amended & Restated Redemption Agreement dated May 7, 2007
+ 10	.8	2005 Stock Incentive Plan
+ 10	.9	Form of Stock Option Agreement Under the 2005 Stock Incentive Plan & Notice of Grant of Stock Option
+ 10	.10	Form of Restricted Stock Agreement Under the 2005 Stock Incentive Plan & Notice of Grant of Restricted Stock
+ 10	.11	Orion Marine Group, Inc. Long Term Incentive Plan
+ 10	.12	Form of Stock Option Agreement Under the 2007 Long Term Incentive Plan
+ 10	.13	Form of Restricted Stock Agreement and Notice of Grant of Restricted Stock
+ 10	.14	Executive Incentive Plan (filed as an exhibit to the Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008)
+ 10	.15	Subsidiary Incentive Plan (filed as an exhibit to the Quarterly Report on Form 10-Q for the quarterly period ended

			September 30, 2008)
+	10	.16	Employment Agreement, dated as of December 4, 2009, by and between Orion Marine Group, Inc. and J. Michael Pearson
+	10	.17	Employment Agreement, dated as of December 4, 2009, by and between Orion Marine Group, Inc. and Mark Stauffer
+	10	.18	Employment Agreement , dated as of December 11, 2009, by and between Orion Marine Group, Inc. and Elliott Kennedy
+	10	.19	Employment Agreement, dated as of December 11, 2009, by and between Orion Marine Group, Inc. and Jim Rose
+	10	.20	Employment Agreement, dated as of December 11, 2009, by and between Orion Marine Group, Inc. and Peter R. Buchler
+	10	.23	Schedule of Changes to Compensation of Non-employee Directors, effective for 2008 (filed as an exhibit to the Quarterly Report on Form 1-Q for the quarterly period ended June 30, 2008)
*	21	.1	List of Subsidiaries
*	23	.1	Consent of Independent RegisteredPublic Accounting Firm
*	23	.2	Consent of Garland Sandhop, CPA
	24	.1	Power of Attorney (included on signature page of this filing)
*	31	.1	Certification of CEO pursuant to Section 302
*	31	.2	Certification of CFO pursuant to Section 302
*	32	.1	Certification of CEO and CFO pursuant to Section 906
*	99	.1	Audited financial statements of T.W. LaQuay Dredging, LLC as of December 31, 2008
*	99	.2	Unaudited financial statements of T.W. LaQuay Dredging, LLC as of September 30, 2009
*	99	.3	Unaudited pro forma condensed combined balance sheet as of September 30, 2009 and statements of income for the year ended December 31, 2008 and nine months ended September 30, 2009 of Orion Marine Group, Inc. and T.W. LaQuay Dredging, LLC

*	Filed herewith
**	Incorporated by reference to the Company’s report on Form 8K filed with the SEC on March 4, 2008
+	Management contract or compensatory plan or arrangement
(b)	Financial Statement Schedules

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and
Shareholders of Orion Marine Group, Inc.

We have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States) the consolidated financial statements of Orion Marine Group, Inc. and subsidiaries referred to in our report dated March 9, 2010, which is included in the annual report to security holders and incorporated by reference in Part II of this form. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15 (2), which is the responsibility of the Company's management. In our opinion, this financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

Grant Thornton LLP
Houston, Texas
March 9, 2010

ORION MARINE GROUP, INC.

SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS
(Dollars in thousands)

Description	Balance at the Beginning of the Period	Charged to Revenue, Cost or Expense	Deduction	Balance at the End of the Period
Year ended December 31, 2007:				
Provision for Doubtful Accounts	$500	$--	$--	$500
Year ended December 31, 2008:				
Provision for Doubtful Accounts	$500	$800	$(500)	$800
Year ended December 31, 2009:				
Provision for Doubtful Accounts	$800	$442	$--	$1,202

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