This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior **Accounting**: Quality of Earnings Issues **Governance:** Corporate Governance Issues

Insider Research Bulletin

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Insider Research Bulletin describes significant insider trading behavior that we have identified at the following companies and is a summary of the first step in our research process. The next step is that these same companies will undergo a review of accounting and governance behavior, and if we identify indicative behavior in one or both areas, then a "full 3DA research report" will be published on that company. Note: Inclusion of a company in this report by itself does not necessarily mean a full research report will be published.

Insider Research Bulletin is published periodically and exclusively for 3DA Research subscribers.

Companies in this Bulletin

- Citizens Communication Co. (NYSE: CZN)
- Reckson Associates Realty Corp. (NYSE:RA)
- Shurgard Storage Centers Inc. (NYSE: SHU)

Discussion of 3DAdvisors Findings

Citizens Communication Co. (NYSE: CZN)

A truly anomalistic round of selling by CZN insiders prompted us to take a closer look into the Company, in spite of its relatively low share price, in the defensive interest of any of our clients who may be contemplating long positions in the shares. In addition to the aggressive insider distribution, upon further inspection a number of interesting governance issues also become evident.

Between August 13th and September 21st, fifteen insiders sold 9,664,826 shares, with the selling starting just a week after the shares dropped 15% as the shares began trading ex the special $2 dividend declared in July and in the wake of the news that second quarter profits fell 30%. We found it curious that so many of the recent sellers chose to do so before the special dividend's ex-date, apparently too anxious to sell to wait for the dividend. Those that did wait for the dividend continued selling for over a month after the post ex-date drop, prompting us to infer that there may very well be a negative surprise over the horizon. Another interesting point is the surprise early resignation of Chairman **Leonard Tow** from the board. Tow had resigned as CEO in

July but had planned to remain on as Chairman through the end of the year. On September 27th, however, both Tow and his wife resigned from the board, effective immediately.

Adding to our interest is the fact that, notwithstanding the apparent urgency to sell, insiders have never converged to sell as they have in this recent round. Between 1995 and 2003 Company insiders sold less than 450,000 shares, in total. Of the recent sellers, five of the fifteen are board members, many of whom have been on the board for nearly ten years and are just now surfacing with their first-ever sales.

Figure 1. CZN Daily Closing Price, March 1, 2004 through September 24, 2004. Blue shaded area is where insiders sold 9,664,826 shares. Source: Reuters and SEC Filings

Though it could be argued that many of the directors, being of retirement age, simply sold to diversify their holdings, we don't buy it. Five of them dropped between 34% and 89% of their holdings, quite a bit more than simple diversification would dictate. What's more, with no established retirement age, seven of the twelve board members who are over the age of 72 have been on the board for an average 17 years apiece, strong evidence of a very entrenched board.

Both literally and figuratively, this board behaves as a good old boys club. There appears to have been a lot of back scratching, judging by executive and director compensation plans. Directors are given the option of receiving a cash annual retainer of $30,000 or 20,000 stock options plus their annual 5,000-option grant, while Lead Director and Chairman of the Compensation Committee **Robert Stanger** was given an additional $80,000 for his services and the Audit Committee's chairman and vice chairman were paid $50,000 and $40,000, respectively, on top of their annual retainer. To put this into perspective, we looked at the director compensation for competitor SBC

Communications (NYSE:SBC). SBC directors are only given an annual retainer of $60,000 (no stock options) with committee chairmen receiving an additional $5,000, except for the Audit Committee chairman who receives $10,000. But this is nothing compared to the compensation of recently resigned CEO Leonard Tow.

The CEO compensation section in the proxy is quite revealing. In addition to the $10 million he has received in cash compensation since 2000, Tow has been awarded an additional $20 million in restricted stock and 3.55 million options (between 2000 and 2003). But there's more. Tow resigned from his executive position in July and will relinquish his board seat at the end of the year. The Company paid Tow $9 million in cash as a retirement payout, including $3.2 million for agreeing to stay on as an adviser, and he will receive office space, support staff, health benefits for himself and his family, and use of the Company jet which was purchased two years ago for Tow's use.

Finally, we should note that Tow's employment agreement calls for the acceleration of payments due should the Company merge or get bought out. In this regard, it doesn't seem to be a coincidence that earlier in the year Tow was shopping Citizens around to a handful of buyers, all of whom thought the asking price was too high. Or, maybe they just didn't want to pay a premium in addition to the costs associated with Tow's golden parachute. Either way, after negotiations failed, Tow then pushed for a special one-time dividend of $2 per share, which was approved by the board in addition to a regular dividend increase that hasn't exactly been received with open arms. In fact, the backlash prompted Citizen's interim CEO, **Rudy Graf**, to open the second quarter conference call with "I just wanted to report that we've now spoken to all of our largest shareholders, and they agree that our dividend decision was a correct one." Apparently, defending this decision takes precedence over the Company's financials and business operations.

It is interesting to note that since the passage of Sarbanes-Oxley and tightening of governance controls, we've seen fewer companies re-pricing stock options. That was until we came across Citizens. Between September 2nd and September 7th, less than two weeks after the issue weakened on the dividend news, the Company held a major round of options re-pricing for 23 executives and directors. This could be one of the largest rounds of re-pricing we've ever witnessed, as a number of insiders had upwards of 15 different options series re-priced. What's more, typically when options are re-priced the insider is given new options for fewer shares, at a reduced strike price, than the original amount. Not in Citizens' case however! Here, insiders were given options for ***more*** shares than they turned in and at lowered exercise prices. What's more, they then wasted little time taking advantage of their new options as a majority of sellers sold shares acquired from the exercise of the newly granted options.

- **Leonard Tow (75)** – Chairman. Tow had previously resigned from his executive position and now has abruptly left his remaining post as Chairman. After having never sold a single share, he's now wasting little time exercising his options and cashing out a big chunk of his position, which in March amounted to 11.5 million shares and exercisable options. He began on August 13th by exercising six series of options with expiration dates ranging from December 2004 to May 2012 and selling the underlying 1.53 million shares plus an additional 1.2 million shares out of his common holdings at just over $14. Then, between September 8th and September 13th he liquidated the entire 5.3 million-share position held by Lantern Investment Company, LLC, of which he is the sole member, at roughly $12.60. The sales

reduced his actionable position by 51%. Tow's remaining holdings consist of 4.36 million shares of common stock and 3,565,799 vested options, which were recently re-priced. In fact, not only did he receive all new options with lower exercise prices, but also picked up an extra 500,000 options in the conversion.

- **John Schroeder (73)** – Director. Schroeder, a director since 1980, surfaced on August 13th to execute his first-ever sale. He exercised three series of options that were expiring between August and January and sold the underlying 77,114 shares. We would typically discount a sale related to expiring options, but there are a few reasons that we find his sales significant. Firstly, he sold just days before the ex date for the special $2 dividend payout, which dropped the stock from over $14 to $12. In addition, he skimmed one of the options, paying $12.80 and accepting $14.20 for the shares. He very easily could've held these shares if he expected a rebound. And lastly, on September 20th he exercised two series of his newly re-priced options, which weren't set to expire for at least eight more years, and sold the underlying 46,520 shares at lower prices than he sold at in August. Combined, his **August and September activity trimmed his holdings by 52%**.

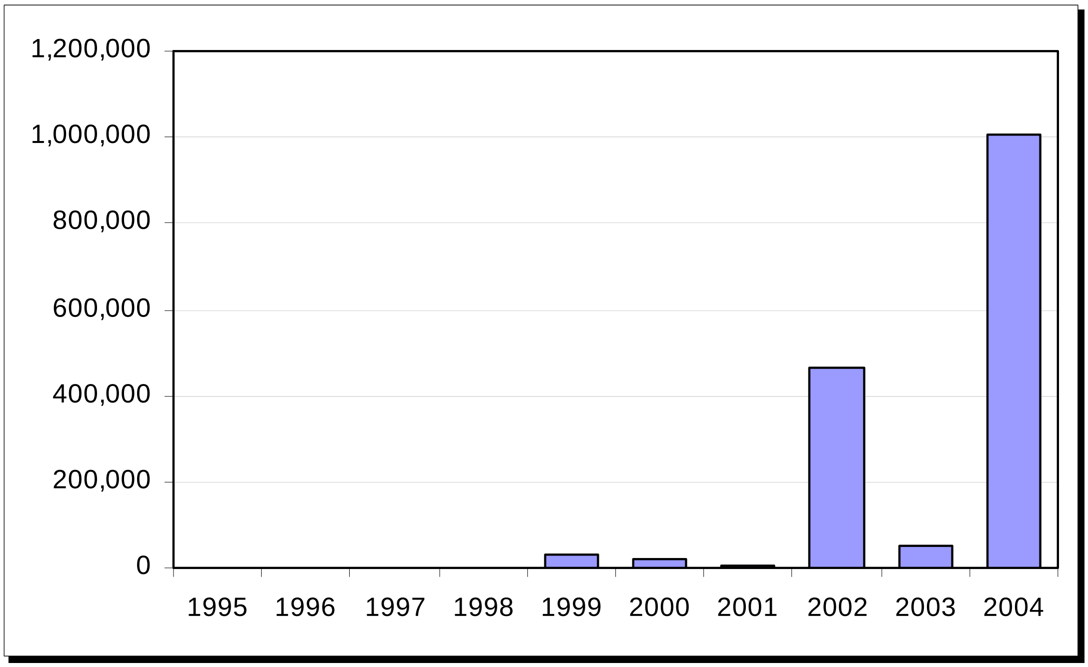
- **Michael Harris (57)** – Senior V.P., Engineering and New Technology. Harris, a Section 16 filing insider since December 2002, executed his first-ever sale on September 21st. Harris exercised the two newly re-priced options series that had immediate vesting provisions and accounted for nearly all of his vested options. He then sold the acquired 243,503 shares at roughly $13.20, which **dropped his ownership position by 69%**. Harris holds no common stock and will not see additional options vest until September 2005.

- **Edward Kipperman (age not disclosed)** – V.P., Tax. After having only sold a total of 29,814 shares between March 2003 and June 2003, Kipperman exercised seven series of non-expiring options (expiration dates: 2/06, 9/07, 4/08, 3/09, 10/10, 5/11, 5/12), five of which were recently re-priced, and sold the acquired 132,460 shares as the issue slid from $14.25 to $12.65. The sales **reduced his actionable position by 60%** and leave him with 38,665 shares of common stock and less than 7,000 vested options.

Reckson Associates Realty Corp. (NYSE:RA)

Reckson is a Company that has been under the microscope over the years for its governance practices. Just a year ago one corporate governance watchdog firm had RA second to last on its overall rankings. A majority of the concerns stemmed from the Rechler family, led by co-founder Chairman **Donald Rechler**, which had five members in senior management and board positions. The Rechler's used the Company as their personal real estate clearing house, buying and selling property to and from it since 1995. And it didn't stop with just real estate deals – in addition to numerous other concessions granted to the Rechler's, Reckson provided $7.5 million in forgiven loans to Rechler family members (in executive positions) to buy RA stock. But it wasn't investor pressure that forced the family to give up some of its control; it was the family's own self-dealings. This unusual relationship between the Company and family culminated in November 2003 when Donald and three additional Rechler family members resigned from their executive positions when the Company disposed a majority of its Long Island properties to the family for approximately $315 million. Donald remains on the board and recently led a group of sellers in what has amounted to the largest round of insider distribution in the past ten years. From June 2nd through September 9th four insiders sold 729,500 shares between the prices of $25.50 and $29.15.

Figure 2. Annual Shares Sold by Reckson Associates Insiders, 1995 through August 2004. Source: RA SEC Filings



Though RA insiders don't have an extensive selling history to analyze, it is apparent that past insider convergences have been well timed, as two earlier rounds were ahead of share-price weakness. Six insiders sold just fewer than 450,000 shares in March 2002, which preceded a one-year slide from $23 to five-year lows of $18. It wasn't until early 2004 that the issue rebounded to 2002 prices and insiders once again cashed out when it did, dumping 275,000 shares into the rally. Now, as the issue has climbed to new ten-year highs, three insiders have cashed out of 40% to 61% of their holdings, led by Rechler who cleared out all of his vested options and even skimmed two of the options series. We will be watching closely for any further developments.

- **Donald Rechler (69)** – Chairman. With his brother Roger, Donald Rechler founded Reckson and took the Company public in 1995. Since leaving his executive position in late 2003, there's been a noticeable change in Rechler's trading behavior: between 1995 and 2003 Rechler had sold a total of just 106,848 shares. More recently however, he has become quite aggressive as from June 2nd to September 7th he cleared out all of his vested options (expirations dates: 11/07, 8/08, 1/08) and sold the underlying 497,500 shares. He then sold an additional 82,000 shares out of his common holdings, effectively **reducing his actionable position by 61%**. But there's more. Rechler skimmed two of the three options series that he exercised, accepting a very small spread between the option's exercise price and the price he received for the shares. He exercised one non-expiring option at $25 and sold the shares at $27, then exercised another series at $27 and sold the shares for $29. It is very rare to see insiders cashing in options, with much time remaining before expiration, for such a small spread. When we see this, we suspect that they feel the risk runs high that the options may be heading under water in the near future.

- **F.D. Rich (48)** – Executive V.P., Chief Accounting Officer. Though Rich's June 2nd sale was a few months back, it shouldn't go unnoticed since he and Rechler were the first to sell into the May rally off the 2004 lows. Since his initial Section 16 (read: insider) filing in November 2003, Rich waited until March 2004 to sell for the first time (for $27 each), ahead of the largest one-month drop in the past five years. He then sold into the rebound (though at lower levels than his March sale), dumping 90,000 shares in June at $25.70. The sale **trimmed his actionable position by 42%**.

- **Philip Waterman (37)** – Executive V.P., Chief Development Officer. Waterman was also a seller in March 2004 ahead of the issue's weakness. He exercised options and sold additional shares out of common, totaling 163,900 shares at roughly $27. The aggressive sale was definitely eye-opening considering he filed as a Section 16 insider just four months earlier, but was even more so once the stock dropped precipitously in the ensuing month. He then joined the other sellers locking in gains into the rebound, selling 40,000 shares on August 12th at $27.80. Combined with his March activity, Waterman's 2004 sales have **shed 40% from his holdings**. Waterman has now exercised all of his vested options and doesn't have any unvested options remaining.

- **Michael Maturo (42)** – Executive V.P., CFO. Maturo's behavior hasn't been nearly as aggressive as his peers, but interesting just the same in the context of the selling by his peers. After selling 14,630 shares in March at $27, Maturo sold an additional 20,000 shares on September 9th as the stock climbed to $29.15. This year's transactions were his first since joining the Company in 1995. Following the sale Maturo has an actionable position in excess of 650,000 shares of common stock and vested options.

<u>Shurgard Storage Centers Inc. (NYSE: SHU)</u>

It's no secret that Shurgard has had its fair share of adversity over the past year. The Company has had to restate earnings dating back to 2001, including the most recent amendment of this year's first quarter 10-Q due to the overstatement of both comprehensive income and shareholder's equity. The Company had to request an extension for its second quarter 10-Q as well. The accounting miscues and lack of controls have caused quite a shakeup. First came the November 2003 resignation of its auditor Deloitte & Touche, who stated that they "could no longer rely on representations of the Company's officials." Months later CFO **Harrell Beck**, an eight-year company veteran, was kindly delegated to a newly formed chief investment officer position. Not only did the stock take a major hit, dropping nearly 20% in less than a month, but credit agencies have cut their ratings to near-junk levels, which doesn't bode well for the Company whose European and domestic credit facilities expire at the end of this year and beginning of 2005. We could go on, but as we suggested above, most of our clients are familiar with these issues.

Given the general scrutiny accompanying Shurgard's accounting issues, we had been waiting to see if, and when, insiders might start providing us additional clues.

We've got them now as four insiders surfaced to sell 181,845 shares from August 20th through September 14th as the issue rebounded to April levels.

Figure 3. SHU Daily Closing Price, March 1, 2004 Through September 27, 2004. Blue shaded area is where insiders sold 181,845 shares. Source: Reuters and SEC Filings.

Though on the surface the volume might not seem that remarkable, reference to historical selling patterns at the Company is quite revealing: between 1995 and 2003 Shurgard insiders had sold a total of just 82,707 shares, a majority of which were sold in August 2003 by just one executive. Moreover, this current activity involves very aggressive option exercising by each of the sellers, all of whom have never displayed this type of behavior in the past. Three of the sellers exercised all of their vested options, exercising upwards of seven different series, and reduced their actionable positions (exercisable options plus common stock) between 44% and 90%.

This significance of this selling becomes even more evident when one considers the fact that none of those involved has more than 20,000 options vesting in the upcoming year. Finally, the Company implemented stock ownership guidelines this year for seven executives and all board members, which have already been met for the most part. There are, however, some unique provisions that limit the amount of shares that may be sold by executives. If an exec hasn't yet reached their ownership targets, they are required to hold a portion of the shares they acquire from option exercises. They are also limited on the number of shares they can sell in a twelve-month period based on their personal stock holdings. Apparently, all four of the sellers were deemed to hold enough shares in order to make these recent largest-ever sales.

- **Harrell Beck (47)** – Executive V.P., Chief Investment Officer, Director. Considering Beck's rank within the Company and the fact that he's the second largest executive shareholder, we were surprised to see that he's only sold once in the past ten years.

In fact, his only prior transaction was a 9,491-share sale into weakness in September 2002. More recently he sold 47,905 shares between August 23rd and September 9th from \$38.80 to \$40.24. The shares sold were obtained from the exercise of three options series (expiration dates: 1/05, 1/07, 1/08), and he actually held 11,000 of the acquired shares. Since he has already met his ownership requirement (he holds 50,693 shares of common), he was not required to hold any of newly acquired stock.

- **Christine McKay (42)** – Senior V.P., General Counsel, Secretary. Since joining the Company in 1998, McKay had only surfaced with one prior transaction, a 12,300-share distribution into weakness in August 2002. We sense a dramatic reversal in her behavior, as on September 1st she exercised all of her vested options, covering seven different series with expiration dates ranging between January 2007 and December 2012, and sold 41,524 of the 81,524 shares at \$39.71. In spite of the fact that she retained some of the shares exercised for, the transaction resulted in a **44% reduction of her actionable position** (common stock plus exercisable options). And the decision to hold a number of the shares wasn't hers. Due to limitations put in place by the Company's stock ownership guidelines, she was required to hold a portion of the acquired shares since she was below her common stock target. Though she now holds 52,144 shares of common stock and is in compliance with the ownership guidelines, she doesn't have any exercisable options and only 14,580 options are set to vest within the next twelve months.

- **Wendell Smith (71)** – Director. Though he's nearing apparent retirement age, Smith's board term isn't up until 2006 and even then he can be nominated for another term. Shurgard's mandatory retirement age is 75, but he would be allowed to finish his three-year term through 2009 should he be re-elected. For this reason we don't discount his recent activity. Between August 20th and September 10th Smith cleared out all seven of the non-expiring options series (expiration dates: 5/06, 5/08, 5/09, 1/10, 1/11, 12/11, 1/13) that he held in a family trust. He subsequently sold all 40,760 shares and then disposed of the last remaining 3,117 shares of common stock in the trust. The selling resulted in a **90% reduction of his holdings** and leaves him with just 4,800 shares of common stock that he holds directly. This was Smith's first sale in the past ten years.

- **Steven Tyler (54)** – Senior V.P., Retail Services. There is an apparent trend of cashing out of options amongst this group of sellers. Tyler is no different; he exercised all of his vested options and sold the shares. Between August 20th and September 10th he exercised five different options series with expiration dates between December 2010 and December 2011. He then sold the acquired shares and an additional 12,200 shares out of his common holdings, for a total of 48,539 shares at prices between \$38.75 and \$40.15. The activity **drained his ownership position by 49%** and leaves him with nearly 50,000 shares of common stock, which is well above the minimum quantity he is obligated to hold under the Company's ownership guidelines.

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