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Analysis and Guidance: The Staff’s Executive Compensation Comment Letters

On August 21st, the SEC Staff began sending the first wave of comment letters on the executive compensation and related party disclosures in 2007 proxy statements, as part of Phase One of its compensation disclosure review project. Phase Two involves a Staff Report that summarizes what the Staff has seen overall—and more importantly—what the Staff expects for the 2008 proxy season; this Report is expected to be issued later this Fall.

Within the next few weeks, as many as 300 issuers may receive comments. The comments come from a special Task Force formed within the Division of Corporation Finance. The Task Force consists of one lawyer from each of the Division’s industry group offices and a handful of senior Staff members that are overseeing the review project. In general, it appears that issuers are selected for review due to their large size and not necessarily because their disclosures are more deficient than their peers.

We thank the many of you that have sent Broc Romanek their comment letters, enabling us to collect a significant number so that we can provide this guidance about the comment letter trends. In this issue (as well as the upcoming issue of *The Corporate Counsel*), we will also provide insight on what you should consider doing going forward, either directly in response to comments or, for the many issuers that have not (yet) received comment letters, in light of the types of disclosures the Staff is seeking.

How to Respond to the Comments

Quite a few readers have asked a variety of questions about how to respond to the comment letters. The style of responding to this targeted review of executive compensation and related

topics should be no different from responding to any other 1934 Act filing review. The response letter should set forth the comment, the issuer’s response, and should be submitted on Edgar as CORRESP to the definitive proxy statement. Issuers should remember that their responses will be available to the public after completion of the review. All confidential items should be redacted per Rule 93 and the unredacted response letter should be submitted to the Staff in paper (as well as a request to the SEC’s FOIA Office). See our November-December 2006 issue of *The Corporate Counsel* at pg. 94.

Unclear Comments

If an issuer doesn’t understand a comment it has received, it should call the Staff member listed at the bottom of the comment letter and ask for further explanation; typically, the Staff will provide more information about unclear comments over the phone. Don’t try to guess what a comment means if you don’t know—that likely will only extend the “back and forth” with the Staff and result in additional (and unnecessary) comment letters. And remember that comments can’t be resolved over the phone—issuers need to respond in writing, even if a Staffer agrees with what is said during a phone call.

Requests for Additional Information

If a comment asks the issuer to “explain” or “tell us about ___” the comment is likely a request for additional information and the issuer should answer as completely as possible. In some cases, the Staff has asked for supplemental information, e.g. “supplementally provide ___” which counsel should submit per 1934 Act Rule 12b-4. (See our November-December 2006 issue of *The Corporate Counsel* at pg. 104.) Many of these “request for additional information” com-



2 ments appear to be centered on the discussion of performance target levels in the Compensation Discussion & Analysis.

Amending Forms 10-K and Proxy Statements

For the most part, the Staff's comments ask for changes in future filings, *i.e.*, the 2008 proxy statement. These comments can be identified because they ask the issuer to, *e.g.*, "revise," "expand," "clarify," "supplement" or "include." (If the comment states "In future filings, [do X]," it's clearly a "futures" comment.) For futures comments that the issuer intends to comply with, it should confirm in the response letter that it will change the disclosure in future filings and briefly explain how it will do so. (*E.g.*, "In the future, the issuer will expand its disclosure of related person transaction policies and procedures to address the types of transactions covered and the standards to be applied.")

Some readers have complained that the Staff's comments are ambiguous about whether changes are required in just future filings or whether an amendment to the issuer's prior filings is required now. This confusion could be alleviated by reading the third paragraph that exists in each of the comment letters, which provides:

In some comments we have asked you to provide us with additional information so we may better understand your disclosure. Please do so within the time frame set forth below. You could comply with the remaining comments in future filings, as applicable. Please confirm in writing that you will do so and also explain to us how you intend to comply. Please understand that after our review of all of your responses, we may raise additional comments.

This paragraph essentially means that a comment is a "futures" comment unless it indicates otherwise. If you aren't clear if a comment is intended to be a "futures" one, it is best to contact the Staff member who signed the letter.

Given that in his recent speech at the ABA's Annual Meeting, Division Director John White left the door open for the Staff to require a Form 10-K/A, it is possible that some issuers might need to file amended disclosure now

rather than wait until next proxy season. (That in mind that amending prior disclosures typically involves just amending the 10-K and not the proxy statement, as the proxy statement is prepared for an annual meeting that will have already taken place.)

Disagreeing with the Staff

For comments that the issuer disagrees with (and does not intend to comply with), the issuer should explain its position, providing the appropriate support and analysis. Specific references to the applicable rules and guidance are necessary, and a description of the complete facts and circumstances surrounding the disclosure is required in order to engage the Staff on an issue. The Staff is expecting that there will be some give and take in the comment process; and the Staff likely will have additional comments or questions. If there are any comments or questions that are not clear, we recommend that the issuer call the Staff member that wrote the comment letter.

In some cases, it may be necessary for the issuer to explain why a comment is not applicable to the issuer's particular situation and why no changes (or perhaps only clarifications in the disclosure) are necessary. For these comments, the issuer should provide the staff with a better understanding of how the company's compensation setting process works and how the disclosure adequately describes the issuer's circumstances.

If the issuer finds itself unable to resolve a comment with the Staff member that issued the comment, depending on the circumstances, it may wish to ask that Staff member to arrange a conference call with the issuer (and/or issuer's counsel), the Staff member and the Staff member's supervisor. In this regard, these comment letters are somewhat different from traditional 1934 Act comment letters because they are issued by Task Force members, some of whom are Special Counsels (whose supervisors are Assistant Directors) rather than more junior Staff members. For these comment letters, the Staff has not yet advised whether the chain-of-command follows the hierarchy of the Task Force (as opposed to the traditional industry group office), but we think that the Task Force's hierarchy likely will be the

chain, particularly because the Staff made a special effort to make the comment letters as consistent as they could before they were sent to issuers.

Note that because the comment letters are dated August 21 (or later), any unresolved issues will not need to be disclosed in the 2007 Form 10-K by M/S/A/AF calendar year filers as the comments will not be outstanding for longer than 180 days before the end of the fiscal year. It's also arguable whether any of these executive compensation comments should be considered "material" so as to trigger disclosure under Item 15 of Form 10-K. (Note that the unresolved comment requirement is applicable to this review because the comment letters are also deemed to be comments on the Form 10-K, which usually incorporates the compensation information by reference from the proxy statement. See our November-December 2005 issue of *The Corporate Counsel* at pg. 6.)

Some readers have asked whether they can completely ignore the Staff if they disagree with a comment and don't intend to comply; in essence, they're asking whether there is a "materiality" standard to comments. This can be a tricky path to walk. First, most issuers attempt to work with the Staff, even if they disagree with some of the comments, to stay in the Staff's good graces. Second, "materiality" should be viewed through the eyes of the Staff, given the power to refer a filing to the Division of Enforcement (as noted in the last paragraph of the comment letters) and perhaps more importantly, decline to declare a registration statement effective. Most practitioners find it easier to work with the Staff—sometimes requesting calls with supervisors if need be—rather than assume the risks associated with having ongoing tiffs with the Staff.

Due Dates

The Staff gives approximately 30 calendar days from the date of the letter to file a response or to let the Staff know when the issuer will respond. We wonder whether 30 days is sufficient time for an issuer to conclude a thoughtful review of the comments, particularly if the changes impact the CD&A (which the compensation committee reviews and covers in its report), because

the issuer's compensation committee should also review the comments and proposed response. **3**

To accomplish this, issuers will likely either need to schedule a special committee meeting during the 30-day period or inform the Staff (as soon as possible) as to when it will be able to respond (e.g., shortly after the next regularly-scheduled compensation committee meeting). Historically, the Staff has been accommodating in granting extensions of time to respond to comments on 1934 Act reports, so long as the issuer has a valid reason for requesting the extension and the length of time requested is reasonable.

Overall Observations on the Staff's Comments

A number of trends are evident from the Staff's comments, which we highlight below and discuss in more detail throughout this issue.

Length of the Comment Letters

The comment letters vary in length. It appears that ten to fifteen comments is the norm, although some issuers received less – while others received significantly more. The Staff indicated that it was holding off on sending comments until it could ensure consistency among the letters, and generally there is consistency across the comment letters—at least with respect to the Staff's major themes—although the wording of the comments may vary from company to company.

Focus on CD&A

By far the most significant concentration of comments is on the CD&A—typically more than half of the comments raised—where, not surprisingly, the Staff is focusing its efforts on eliciting more analysis of compensation practices and decisions. In some cases, the Staff makes very open-ended requests for further analysis. In other situations, the Staff focuses on particular aspects of the CD&A disclosure. The Staff's concerns primarily center on: disclosure about the relationship between the CEO's compensation and the actual compensation of the other NEOs and others; benchmarking and peer group descriptions; the role of executive officers (in particular the CEO) in compensation decisions; the use of

- 4 discretion in setting actual pay amounts; how payment and benefit levels are determined for termination and change-in-control situations and how they fit into the issuer's overall compensation program; and location of the CD&A in the compensation disclosure.

Performance Target Levels

When the rules were amended last summer, the proposing release indicated that when target levels were withheld from the discussion of performance-based compensation due to confidentiality, "the company may be required to demonstrate to the Commission or its staff that the particular factors or criteria involve confidential trade secrets or confidential commercial or financial information and why disclosure would result in competitive harm." (See Rel. No. 33-6732A, Section 11.02 (August 27, 2006).)

The Staff is now delivering on this promise, requiring supplemental submissions that support withholding specific performance target levels. It is likely that this comment will result in the most "back and forth" between issuers and the Staff, as the contours of the basis for withholding the information is developed through the arguments made by issuers and their counsel. The Staff is also raising questions about the adequacy of the alternative "degree of difficulty" disclosure that is provided when performance target measures are withheld.

Termination and Change-in-Control Disclosure

The Staff's comments demonstrate a preference for a tabular presentation of this information. Typically, the staff requests a more comprehensive discussion of the payment and benefit levels and how they are determined. In some instances, the Staff requests that the amounts reported be totaled to provide investors with a "bottom line" figure for each NEO under each different scenario. The Staff's comments do not focus on particular assumptions used for computing the amounts presented, which has been a source of some confusion in preparing this disclosure and led to a lack of comparability this past proxy season. It appears that the Staff is attempting to address these more technical issues through its Compliance and Disclosure Interpretations—for example, CDI Question 11.01

outlines the method for valuing accelerated options in the termination and change-in-control disclosure.

Tables and Other Narrative Disclosures

On the other areas of executive compensation disclosure, the Staff's comments are relatively light. In general, the Staff raises technical comments about compliance with particular elements or instructions to the tables (typically involving a relatively minor item that has been overlooked), and raises particular comments about the accompanying narrative in only a few cases.

Areas of Little Staff Interest

Despite the concern raised earlier this year by Chairman Cox about the length and readability of the executive compensation disclosures, the Staff does not appear to focus on compliance with the plain English rules (new Rules 13a-20 and 15d-20 apply plain English principles to the executive compensation and related disclosures). While the Staff objects to the use of defined terms or abbreviations in some instances, or the approach used to present a particular supplemental table, the Staff overall does not raise the type of plain English comments that were prevalent when plain English was adopted for prospectuses in the late 1990s.

Rather than focusing on eliciting concise explanations, in many cases the Staff requests an expansion of existing disclosure or additional explanations. The lack of Staff comment in this area should not be read as a sign that plain English compliance was judged to be adequate by the Staff; rather, the Staff has probably decided to not get bogged down by plain English during this targeted review project. Plain English compliance may well be revisited once the major disclosure issues have been worked out.

Another area where comments are noticeably scarce is perquisites disclosure. The Staff does not appear to be raising questions about the perquisites disclosed, or the methods for computing aggregate incremental cost. This trend may reflect the Staff's inclination to not provide interpretive guidance (in this case, through the comment process) on identifying an item as a perquisite and, once identified, determining its

incremental cost. Notwithstanding the apparent lack of Staff interest, issuers should continue to carefully evaluate the perquisites provided, why they are provided and how to most accurately value—and disclose the calculation of—the incremental cost to the issuer. (See our May/June 2005 issue of *The Corporate Counsel* at pg. 1.)

Given the two-phase nature of the Staff’s targeted review project, it may be developing guidance about these (and other) issues without raising particular concerns through the comment process. The Staff may believe that some issues should be addressed globally, rather than through individual comments to issuers that might have, in the end, slowed down its review project.

Putting the “A” Back Into CD&A

A major disappointment of this year’s proxy season is the widespread lack of analysis in the CD&A. Many issuers were inclined to present an inventory of compensation elements with only a cursory description of how each element is determined and how they relate to each other as a whole. Often, issuers did not take the extra step to explain how individual compensation decisions related to specific compensation policies and their overall executive compensation program. In too many proxies, issuers focused their analysis on the relationship of executive pay at the issuer to the pay at benchmark companies (which were not always identified)—and little analysis was provided regarding the relationship between executive pay and the issuer’s own compensation philosophy or policies, and how that was carried out by analyzing the compensation paid to the CEO in relation to other executives and employees.

As we noted in our Special Supplement to the September-October 2006 issue of *The Corporate Counsel* (at pg 4), our hope was that the requirement for analysis in the CD&A would serve as a powerful new motivator for compensation committees to implement important tools for critically analyzing CEO and executive compensation and for CEOs to implement changes to make fixes where compensation has gotten “out of line.” (See also the “CD&A pointers” in the September-October 2006 issue of *The Corporate Counsel* at pg 4.) Unfortunately, in too many

cases this past proxy season, issuers sought to sidestep the hard truths that meaningful analysis should reveal. We applaud the Staff for seeking to put the “A” back into the CD&A with comments targeted at analytical issues.

Prominence of CD&A

While the Staff’s comments largely focus on the substance of the CD&A, the Staff reminds issuers that the CD&A should come first in the executive compensation disclosure, preceding the SCT and other tables. This comment is consistent with language in Section II.B.2 of the adopting release. While it may seem to be a minor point, the placement of CD&A before the quantitative disclosure facilitates analysis and provides the necessary context for the tabular presentations that follow.

General Requests for Analysis

While in many cases the Staff’s comments are specific to particular elements of the CD&A, some comments are very broad. In their reach, these comments request a significantly revised CD&A that includes an analysis of how each compensation element was determined and why the issuer paid each particular form and level of compensation. In these broad comments, the Staff requests disclosure of the factors considered by the compensation committee in approving the elements of each NEO’s compensation package, as well as the reasons why the compensation committee believes that the amounts paid are appropriate in light of the items that the committee considered in making its compensation decisions. The tone of these comments, which readily repeat the rule’s requirements, appear to reflect the Staff’s view that the particular issuer should “try again” with its CD&A.

Compensation for Individual NEOs and Internal Pay Equity

One of the most common CD&A comments is that the issuer must make the CD&A sufficiently precise so as to identify material differences in compensation policies and decisions for individual NEOs.

Many of these comments focus on the size of compensation packages for individual NEOs—particularly the CEO—relative to the compensation paid to the other NEOs. The Staff requests an explanation of the reasons for differences in

6 the amounts awarded to each of the NEOs. The Staff references Section M.D.1 of the adopting release as the basis for this comment. Some readers have wondered whether these comments may be establishing a materiality threshold for an issuer's future disclosures—so that issuers will now need to provide an explanation in CD&A whenever there is a significant difference in pay (say, for example, a 2-to-1 difference in the CEO's total compensation relative to the next most highly paid NEO).

The Staff also requests a specific discussion of how the compensation committee evaluates the internal pay relationship among its executives and others in setting compensation. For example, the Staff asks whether the committee analyzes the multiple by which an NEO's compensation is greater than that of other specified employees. As we noted in our September-October 2005 issue of *The Corporate Counsel* (at pg 4), internal pay equity is a critical consideration for compensation committees when considering and setting executive pay—such an analysis is also essential to provide perspective whenever benchmarking against other companies is considered or presented. (See the extensive materials and guidance regarding internal pay equity provided on CompensationStandards.com.) It is laudable that the Staff is seeking more fulsome disclosure regarding this consideration.

Moreover, the Staff is seeking more discussion of the ways in which the issuer structures and implements specific terms of compensation in order to reflect the individual performance of NEOs. The Staff is looking for a discussion of both quantitative and qualitative elements of individual performance, as well as the specific individual contributions that were considered by the compensation committee when determining the amount of compensation for each NEO. In many instances, the Staff requests disclosure as to weightings or other ways in which the individual contributions are considered in setting each NEO's compensation.

More analysis is also sought concerning individual employment agreements, with the Staff requesting expanded discussion of why the issuer structured the terms and payments in the way that is reflected in the agreements.

All of the above information and analysis relates to assessing internal pay equity, even though the term "internal pay equity" itself may not have been mentioned in a particular comment letter.

Use of Discretion

The Staff focuses on any disclosure concerning the use of discretion in setting compensation, and seeks expanded disclosure about the scope of this discretion and its use by the compensation committee. Specifically, the Staff requests that the issuer disclose the extent to which the compensation committee has discretion, circumstances that would result in the use of discretion, the elements of compensation that are subject to adjustment and whether or not discretion has been exercised in setting pay for the NEOs. In those circumstances where discretion was exercised when performance goals were not met, the Staff seeks disclosure of the factors considered by the compensation committee in determining awards on a discretionary basis.

Role of Executive Officers, the Compensation Committee and the Board

The Staff is seeking greater clarity as to who determines compensation for the NEOs, particularly the CEO's compensation. The Staff asks for disclosure of the responsibilities of the compensation committee, the board of directors and their interaction when making compensation decisions.

The role of executive officers in determining executive compensation is a focus of significant Staff comment. Some of the activities noted by the Staff are the ability of the CEO to call or attend compensation committee meetings, whether the CEO met with the compensation consultant used by the compensation committee, whether the CEO had access to any other compensation consultant who influenced executive compensation and the amount of input the CEO had in developing compensation packages.

In some cases, the Staff requests information as to how the compensation committee uses tally sheets, including whether the committee increased or decreased the amount of compensation awarded based on the tally sheet information. As we noted in our September-October 2005 issue

of *The Corporate Counsel*, tally sheets are an important tool for compensation committees and we believe that issuers should fully (and proudly) describe their use of tally sheets as a means of assessing the total compensation paid (and to be paid) to the CEO—and for explaining compensation decisions and the rationale for such decisions.

Termination and Change-in-Control and Termination Arrangements

In many of the comment letters, the Staff is requesting a more thorough discussion and analysis of termination and change-in-control arrangements under Reg. S-K Item 402(b)(2) and (3). In particular, the Staff is looking for discussion and analysis of how the actual post-termination awards and benefits are determined, why the issuer has chosen to pay multiples of compensation components as severance or change-in-control payments and why vesting of equity awards is accelerated. In addition, the Staff requests additional disclosure about how these arrangements fit into the issuer's overall compensation objectives and affect decisions made as to other compensation events, and the rationale for decisions made in connection with these arrangements.

In some circumstances, the Staff asks whether the terms of change-in-control agreements are based on negotiations or through an evaluation of benefits paid by peer companies. Finally, the Staff expects significant differences in the terms of these agreements among the NEO group to be addressed in the CD&A. It is clear from the nature and frequency of these comments that the Staff is seeking significantly more discussion and analysis regarding these arrangements.

Wealth Accumulation

The comment asking whether—and how—companies factored in other elements or pay when determining severance and change-in-control compensation is an important reference to the fact that compensation committees need to be performing a wealth accumulation analysis when making compensation decisions—and providing that analysis in the CD&A. (For more on the importance of wealth accumulation analysis, see our September-October 2005 issue of *The*

Corporate Counsel at pg. 9, our Special Supplement to the September-October 2006 issue of *The Corporate Counsel* at pg. 6, and the guidance provided on CompensationStandards.com.)

Option Granting Practices

As contemplated by the guidance in the adopting release, the Staff asks for disclosure about option granting practices when they are not fully discussed in the CD&A. For example, in some comments, the Staff asks issuers to disclose whether options may be granted at times when the board or compensation committee is in possession of material non-public information.

Performance-Based Pay Disclosure

With roughly half of the larger issuers failing to provide disclosure about specific performance target levels (presumably relying on the ability to withhold this information if it is competitively harmful), this is an area where the Staff almost uniformly raises comments. Without disclosure of the performance target levels, it can be very difficult for investors to assess the compensation picture, and the actual compensation paid, in the context of the issuer's pay-for-performance philosophy. Lack of disclosure about the performance metrics and specific target levels can also make the analysis in the CD&A more difficult, as concrete numbers necessary to demonstrate the effectiveness of its pay-for-performance program are absent.

Performance Target Levels for the Current Year

One of the more surprising areas of Staff comment (except for those who previously saw the comment raised in connection with a recent IPO) is on the disclosure of performance target levels for the current year, rather than just for the last completed fiscal year. Most of the issuers that did provide target levels only did so for the last completed fiscal year. It now appears, however, that the Staff is expecting current year target levels to be disclosed as well. Apparently Instruction 2 to Item 402(b) is the rationale for this comment, which requires disclosure about actions taken after the end of the fiscal year with respect to compensation policies and decisions. We expect some back and forth between the Staff and issuers here, particularly regarding the

- 8** extent to which the current year measures and targets are (or are not) material to an understanding of an issuer's compensation program and policies.

Withholding of Performance Target Levels

When performance target measures are withheld, the Staff's comment asks for a supplemental explanation of the basis for withholding the information under Instruction 4 to Item 402(b)(2). Alternatively, the issuer can disclose the target level. At this point, it is unclear whether the Staff will require an amendment to the Form 10-K if, after considering the issuer's explanation, the Staff determines that there was no basis for withholding the target level. In responding to this comment, issuers should provide the same level of argument and analysis as they would with a Rule 240-2 request for confidential treatment. SK 402 CD Question 3.04 provides guidance on the case law that should be analyzed when formulating a response.

"Degree of Difficulty" Disclosure

When performance target levels are withheld because of potential competitive harm, Instruction 4 to Item 402(b)(2) requires alternative disclosure about how difficult it will be for the executive—or how likely it will be for the issuer—to achieve the undisclosed target levels. The Staff's comments on this disclosure indicate that general statements regarding the level of difficulty or ease associated with achieving goals (as well as using jargon like "stretch goals"), are resoundingly insufficient.

While the Staff does not provide any guidance in the comments on what is considered acceptable "degree of difficulty" disclosure, issuers should seek to provide disclosure here that describes whether the target is a "real" target to serve as an incentive for an executive, or whether it is merely a modest target where achievement is relatively assured. In the absence of specific quantitative levels, the use of historical data and an explanation of past experience with particular targets can help immensely in describing the "reality" of the target. This is an area where more interpretive guidance from the Staff would be welcome so that issuers can have a better sense of how to satisfy this disclosure requirement.

Enhanced Disclosure Regarding Performance Plans

Staff comments seek more disclosure about (i) how the issuer has tailored incentive awards around specific performance goals, (ii) how the issuer determines the amount and (iii) where applicable, the formula for each element of compensation. In many instances, the Staff notes that disclosure concerning performance-based compensation is difficult to understand. In some cases, the Staff suggests that the issuer should provide more insight into the factors considered by the compensation committee before awarding the performance-based compensation, including any historical analyses or correlations between historical bonus practices and the incentives set for the relevant fiscal year.

The Staff also requests a tabular presentation comparing actual results to targets, and in some cases, hypothetical examples as a means of demonstrating the operation of complex performance-based plans. Where the formula is just to satisfy Section 162(m) and then negative discretion is used, it should be disclosed that these are *not* real performance conditions. Issuers may be misleading their shareholders by not telling them that these are conditions just to make it seem like they are meeting Section 162(m).

Benchmarking

A surprisingly large number of the Staff's comments focus on benchmarking disclosures. Overall, it appears that the Staff is not satisfied with the disclosure about peer groups and the explanations about the relationship of CEO compensation to benchmarked percentiles.

Identification of Peer Group

In some circumstances, the Staff questions whether the issuer benchmarks to companies other than those identified in the peer group, and asks for the identity of those companies as well as any analysis performed. When the issuer benchmarks against particular groups (including industry-specific compensation surveys, even standardized "off-the-shelf" surveys), the Staff appears to expect identification of all of the companies comprising the group. In some situations, the Staff asks whether the compensation committee adjusts its analysis of comparable

companies based on variations in size of the companies in the group.

Targeted Percentiles

When issuers disclose that they pay compensation to a specific percentile of the comparator group, the Staff requests disclosure of where actual payments fell within the targeted parameters (and seeks an explanation and analysis if the actual compensation paid is outside of the targeted percentile). The Staff also requests specific disclosure of the percentiles targeted for total compensation and individual benchmark elements of compensation. (Using in some cases that references to average targeted compensation for the NEOs are inappropriate.)

Further, the Staff asks for disclosure of when discretion may be used to pay amounts other than within the range of the percentile selected. These comments focus on expanding the analysis of peer and survey comparisons to require specific analysis about how the information is used by the compensation committee—and the extent to which it is actually followed in making specific compensation decisions. The comments on this topic, as with the comments about consideration of individual factors in setting pay, tend to indicate a Staff view that compensation arrangements are purely formulaic, which of course may not be the case. These comments may present situations where it is necessary to explain to the Staff how the issuer’s compensation program works and why, in the issuer’s particular circumstances, the information may be immaterial or unavailable.

Termination and Change-in-Control Arrangements

In addition to the enhanced CD&A disclosure concerning termination and change-in-control arrangements, the Staff focuses on compliance with the narrative disclosure requirements in Item 402(j). The Staff’s comments are directed at improving the overall presentation of termination and change-in-control arrangements, and in particular, the all important reasons behind these arrangements.

Tables

While Item 402(j) provides issuers with some flexibility in determining how best to present this

disclosure, the Staff indicates a strong preference for a tabular presentation in its comments. It appears that the Staff will push issuers toward tables in an effort to streamline this disclosure and perhaps make it more understandable.

Terminology

The Staff requests definitions (in plain English) for terms such as “cause,” “good reason,” “change-in-control” and other similar terms included in these types of arrangements.

Triggers

In some cases, the Staff asks for an explanation of the specific circumstances that would trigger termination and change-in-control payments.

Amounts Payable

The Staff requests quantitative information for all amounts payable under termination and change-in-control agreements under all triggering events, along with discussion and analysis of how the actual post-termination benefits and awards were determined—including why various multiples to particular elements of compensation were chosen.

Totals

While the rules do not require a total that sums up the elements of post-employment compensation for each triggering event, it is clear that under the “principles matter” approach the Staff expects issuers to follow, a totaling up of the numbers is necessary—instead of making shareholders hunt and try to piece together the puzzle. This approach is reflected in the Staff’s comments requesting totals. In most situations, we think that such totals will give shareholders a better idea of the real “walk away” value of the issuer’s termination and change-in-control agreements.

Notable Comments on Compensation Tables, Corporate Governance Disclosures and Related Person Transaction Policies

Summary Compensation Table

Many practitioners believe that the December 2006 rule changes in the SEC unnecessarily complicated this table and make it more difficult for investors to understand equity award grants

10 practices and the total compensation of NEOs. Those issuers who have sought to address these problems through the use of an "alternative" SCT to (or following) their CD&As received comments indicating that the table should not be given greater prominence than the required SCT, and should not be presented in a manner that makes the information appear to be part of the required tabular disclosure. Similarly, disclosure implying that the issuer's own analysis of how the issuer pays its executives should serve as a substitute for the information required by SEC's rules (including the amounts disclosed for equity awards in the SCT) is discouraged. Unfortunately, these comments may discourage issuers from taking the necessary steps to explain, under the principles-based standards of the rules, how the compensation decisions are made and how they can be analyzed in light of the required disclosure.

In some cases, the Staff requests that assumptions made in the valuation for the stock and option awards columns be disclosed by reference to a discussion of those assumptions in the financial statements or MD&A. This comment may be in error when made with respect to awards (such as deferred stock units) where there are no "assumptions," and the proxy statement indicates that the FAS 123R value for the awards is equal to the fair market value of the underlying stock on the date of grant.

Narrative Accompanying the Summary Compensation Table

Some comments request that disclosure concerning things such as incentive plans be moved from the narrative accompanying the SCT to the CD&A. This comment seems to run counter to the notion that the CD&A is meant to be an overview—and may unnecessarily lengthen CD&As at the expense of more complete descriptions accompanying the tables. Alternatively, some comments ask that the disclosure about plans be repeated in the narrative accompanying the SCT.

For issuers providing NEOs with requisite allowances, the Staff asks for a discussion of how the requisite allowances amounts were determined; a general identification of the items toward which the requisite allowance can be spent; and the specific items purchased with the allowance in the prior year. The Staff also requests

disclosure of any compensation committee discretion in providing additional amounts for perquisites over and above the specified allowance.

Outstanding Equity Awards at Fiscal Year End Table

A common comment is that the table should include the vesting dates of awards held at fiscal year end using a footnote to the applicable column under instruction 2 to item 402(j)(2).

Director Compensation

Quite a few of the comment letters request footnote disclosure of the grant date fair value of equity awards made during the last completed fiscal year, as well as the number of awards outstanding at fiscal year end. As with the SCT, the Staff also asks for disclosure referencing the assumptions used to value stock and option awards. In some cases, the Staff seeks disclosure of consulting fees, charitable awards and other compensation paid to directors. More analysis of director compensation arrangements is requested of some issuers, although the Staff does not appear to be calling for a "mini-CD&A" for directors.

Compensation Committee Disclosures

In over half the comment letters, the Staff seeks more detailed disclosure of the role of compensation consultants in determining (or recommending) the amount or form of compensation, including a materially complete description of the nature and scope of the compensation consultant's assignment and the material elements of the instructions or directions that were given to the consultant. The Staff suggests that individualized disclosure is necessary for each compensation consultant involved in the process of setting director compensation and executive compensation.

In some cases, the Staff asks for more detail regarding the role of the compensation committee and the board with respect to CEO and other senior executive officer compensation.

Director Independence

Some of the Staff's comments focus on an adequate description of the independence standards applied, including (where applicable) where additional independence standards are considered over and above the standards established by

exchange listing standards. In some instances, the Staff asks whether there were any transactions considered by the board that are required to be disclosed under Item 407(a)(3).

Related Person Transactions

Some of the Staff’s comments direct issuers to provide a more complete description of policies and procedures to be applied for the review or approval of related person transactions, including the standards applied, as well as whether the policy is in writing. It is apparent from these comments that a mere passing reference to such policies is not sufficient.

A Thank You

We all owe a special “thank you” for the above analysis and guidance to our own David Lynn (who, as our readers know, until this past June was a key member of the Staff’s executive compensation disclosure project). Thanks also to Mark Borges, Alan Dye and Ron Mueller for their thoughts. And, again, thanks to the many of you that shared your comment letters.

Moving Forward

We will provide further analysis as the Staff’s review efforts proceed. Even as the hard work on resolving outstanding comments with the Staff continues over the next few months, it is not too early to start looking toward next year’s proxy statements. The Staff provides some critical guidance in this first round of comment letters, in particular on what level of analysis is necessary in the CD&A with respect to the compensation of individual executive officers, the rationale for termination and change-in-control payments, benchmarking and performance-based pay.

These additional disclosures may ultimately result in longer—and perhaps more complex—

proxy statements, but we believe that the Staff should be willing to sacrifice some length and complexity concerns in order to get the analysis originally contemplated for the CD&A.

The Upcoming Issues of *The Corporate Counsel* and *The Corporate Executive*

Because our readers will not want to wait two months between issues, and because most of our readers already subscribe to both *The Corporate Counsel* and *The Corporate Executive*, we will blur the lines and continue our guidance from one issue to the next. We are already working on the September-October 2007 issue of *The Corporate Counsel*. In light of the Staff’s comment letters—and our own internal review of this past year’s proxy disclosures—we will be providing our “Ten Compensation Disclosure Fixes” that companies will need to address *now* for next year’s proxy statements.

Any readers (or colleagues) who do not subscribe to both newsletters are encouraged to enter no-risk trials to keep abreast of the ongoing proxy disclosure developments and our guidance.

Also, in view of the SEC’s heightened focus on this coming year’s proxy disclosures, we would urge any readers who have not yet done so, to sign up ASAP for the October 9th Conference—“Tackling Your 2008 Compensation Disclosures: The 2nd Annual Proxy Disclosure Conference”—to attend either in San Francisco or by the Nationwide Live Video Webcast. Just as critical now (especially for your CD&As—with the SEC’s much greater expectations), make sure to sign up for the October 11th Conference: “Lessons Learned” *Necessary Compensation Fixes—Impacting Your Proxy Disclosures* (also in San Francisco and via Nationwide Live Video Webcast).

—J.M.B.

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