A N T H O N Y D . F O T I
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November 28, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

RE: File Number S7-03-06
Executive Compensation Disclosure (17 CFR Part 229)
Request for Additional Comment

Dear Ms. Morris:

I. Introduction

I am commenting on the Securities and Exchange Commission's (the "Commission") proposed amendment to the disclosure requirements for executive and director compensation, namely the proposal to require compensation disclosure for three additional highly compensated employees.

I thank the Commission for providing me with the opportunity to comment on the proposed amendment to the disclosure requirements for executive and director compensation.

To facilitate the Commission's consideration of this comment, I will provide a brief description of my background, summarize my comment and then explain the reasoning underlying my comment.

II. Commenter's Background

I write as a concerned citizen who has followed securities regulations for several years. I have reviewed the comment letters addressing executive compensation disclosure and have participated in numerous discussions with academics and legal practitioners concerning the proposed rule.

I am a third year law student at the Villanova University School of Law in Villanova, PA, where I am also the Managing Editor of the *Villanova Law Review*. I was the 2004 Valedictorian of The Pennsylvania State University, graduating with a degree in finance. I have accepted a judicial clerkship with the Honorable Dennis M. Cavanaugh in the U.S. District Court for the District of New Jersey (Newark, NJ) for the 2007-08 term. I will thereafter commence my employment as an associate in the corporate and securities group at Pillsbury Winthrop Shaw Pittman, LLP (New York, NY). At Pillsbury, I will be involved with drafting agreements and advising clients with issues related to the proposed rule.

Please note that this comment represents my views only and not necessarily the views or positions of the Villanova University School of Law.

III. Overview

I welcome and support the Commission's decision to revisit its rules addressing disclosure requirements for executive compensation. I concur with the Commission's views that the existing disclosure rules, largely adopted in 1992, have worked well, have proven remarkably resilient over the past fourteen years and have established a framework that can and should be largely continued. I also agree, however, that it is appropriate to revisit some of the policy decisions and resulting disclosure standards to address areas where additional or revised disclosure rules may be beneficial to investors.

Executive compensation decisions are governed by state laws addressing the duties and responsibilities of directors and executive officers, corporate governance listing standards adopted by the stock exchanges and, to a lesser extent, federal tax law. The disclosures involve some of the most sensitive issues that exist in the governance of an entity: who is managing the entity, how and toward what goals is management being incented and what is management gaining from the entity as a result. I strongly believe that the Commission's role and objective should be to support adequate disclosure to investors of the decisions and resulting payments that are made by registrants, and of the context in which those decisions occur, which can promote accountability to investors. The Commission's rules should recognize and accommodate this context, but should to the greatest extent possible not operate in a manner that impinges on or improperly influences the decision-making processes of directors. The rules must balance the need for disclosure to investors with the need for a business to attract, retain, develop, promote, transition and, when necessary, discharge the managers of the business.

My comments below generally support the Commission's proposals to expand and enhance the disclosure of executive compensation. In light of the considerations set forth above, in only a few instances have I questioned the appropriateness of proposed disclosures. In most cases, I either support the Commission's proposals or comment only on the manner, format or location in which compensation or other matters are proposed to be disclosed. I have also provided a number of technical comments so that the rules accommodate or reflect actual practice. In making these comments, three broad themes underlie my analysis:

- The rules should be designed to elicit information on the corporate governance context in which compensation decisions are made without unduly or inappropriately affecting that context.
- The rules should be designed to elicit information that is meaningful and useful to investors without implicitly passing judgment on the appropriateness of certain arrangements or on the forms or amounts of compensation.
- The rules should be designed to present fair and accurate disclosures that avoid anomalies in presentation that could arise as a result of different companies using different forms of compensation.

IV. Summary of Comment

<u>The Commission Should Not Adopt the Proposed Rule Verbatim</u>

I commend the Commission for undertaking such a comprehensive review of the Securities Acts requirements regarding executive compensation. The Commission should not, however, adopt the proposed rule using the current language. The proposal:

- is unclear and difficult to implement;
- will not provide material information to shareholders;
- will invade employee privacy interests and negatively affect employee morale; and
- will undermine the ability of businesses to retain key employees.

Therefore, I recommend that the Commission modify the proposed rule as summarized below and discussed at greater length later in this comment. I believe that these changes are necessary to make the proposed rule more effective, minimize confusion and permit practical and efficient implementation.

- The Commission should formulate a *de minimis* exception to the disclosure requirements for immaterial items, consistent with the focus of the Securities Acts on providing investors with material information.
- Deferred compensation should not include market-rate earnings; only above-market or preferential earnings should be disclosed and included.
- The named executive officers ("NEOs") should include the principal executive officer ("PEO"), principal financial officers ("PFO") and the three most highly compensated other officers. However, the selection of the three other NEOs should be based on salary and bonus and not on "total compensation" as proposed by the Commission.

- The proposed "Compensation Discussion and Analysis" section should be a report of the board compensation committee that is furnished and the rules should specifically reaffirm that the report is not required to address subjective individual performance assessments for NEOs other than the PEO.
- Disclosure should not be required of compensation paid to non-executives.
- The determination of those NEOs who are covered by the proposed disclosures should not be based upon a measurement that includes pension or deferred compensation accruals. The present approach of examining the executive officers' salary and bonus best avoids anomalies in the determination of NEOs.

V. Background

On January 27, 2006, the Commission proposed revisions to the rules governing disclosure of executive compensation, director compensation, related party transactions, director independence and other corporate governance matters, current reporting regarding compensation arrangements and beneficial ownership.[1] As part of the Item 402 narrative disclosure requirements, the Commission proposed an additional item that would have required disclosure for up to three employees who were not executive officers during the last completed fiscal year and whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers.[2] The Commission reported receiving over 20,000 comment letters in response to the proposals. In general, commenters supported the proposals and their objectives.[3]

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[1] *See Executive Compensation and Related Party Disclosure,* Release No. 33–8655 (Jan. 27, 2006) [71 FR 6542] (the ''Proposing Release'').

[2] *See* 5 Proposed Item 402(f)(2).

[3] See, *e.g.*, letters from the Corporate Library; The Greenlining Institute; Institutional Investor Group; and State Board of Administration (SBA) of Florida. *But see e.g.*, letters from American Bar Association, Committee on Federal Regulation of Securities; Chamber of Commerce of the United States of America (''Chamber of Commerce''); Eli Lilly and Company (''Eli Lilly''); Leggett & Platt, Incorporated (''Leggett & Platt''); Nancy Lucke Ludgus; and Mercer Human Resource Consulting (''Mercer''); letters from American Bar Association, Joint Committee on Employee Benefits; Business Roundtable; jointly, CBS Corporation, The Walt Disney Company, NBC Universal, News Corporation, and Viacom, Inc. (''Entertainment Industry Group''); Committee on Corporate Finance of Financial Executives International; Chamber of Commerce; Cleary Gottlieb Steen & Hamilton LLP (''Cleary''); CNET Networks, Inc. (''CNET Networks''); Compass Bancshares, Inc. (''Compass Bancshares''); Compensia; Cravath, Swaine & Moore LLP (''Cravath''); DreamWorks Animation SKG (''DreamWorks''); Eli Lilly; Emerson Electric Co.; Fenwick & West LLP; The Financial Services Roundtable (''FSR''); Professor Joseph A. Grundfest, dated April 10, 2006; Investment Company Institute (''ICI''); Intel Corporation (''Intel''); Kellogg Company (''Kellogg''); Kennedy & Baris, LLP (''Kennedy''); Mercer; Peabody Energy Corporation (''Peabody Energy''); Pearl Meyer & Partners; Securities Industry Association (''SIA''); Sullivan & Cromwell LLP; Society of Corporate Secretaries & Governance Professionals (''SCSGP''); and WorldatWork.

On July 26, 2006, the Commission adopted the rules and amendments substantially as proposed, with modifications reflecting the concerns raised by commenters.[4]

The Commission, however, did not adopt the proposed disclosure requirement regarding the total compensation and job description of up to an additional three most highly compensated employees who are not executive officers or directors, but who earn more than any of the named executive officers. The Commission instead decided to solicit additional comments on this issue.

The efforts of Chairman Cox, the Commission and its staff to adhere to a balanced, common sense approach to enhancing the disclosure of executive compensation are commendable. The following are some suggestions to improve disclosure of information that will help investors better understand the kinds of behavior that compensation plans are intended to reward and, therefore, are most likely to produce.

VI. Detailed Comments Regarding the Proposed Rule

A. Proposal to Require Compensation Disclosure for up to Three Additional Employees

The Commission's overhaul—compensation, perquisites and retirement—on the three highest paid executives misses the mark by not requiring the same information on the remaining employees in the organization. It focuses too much on the three highest paid executives and the directors, neglecting other employees. Knowledge of the remaining employees in the organization is important for two reasons: (1) executive pay should be determined and judged against other employees in the organization; and (2) empirical evidence shows that companies perform better when stock options or share ownership are widely distributed throughout the organization (e.g., to mid-level managers).

Executive pay levels at large U.S. companies are the subject of ongoing public debate. Most often, executive pay is seen as increasing while real wages of salaried employees stagnate or decrease. Critics of high executive pay attribute the unchecked growth in pay levels to weak governance and corporate boards that lack independence from management.

While investors benefit from disclosure of compensation levels in absolute terms, disclosures seldom speak to the "how and why" behind the board's decisions on executive compensation.

[4] *See Executive Compensation and Related Party Disclosure,* Release No. 33–8732A (Aug. 29, 2006) (the ''Adopting Release'') published in this issue of the Federal Register.

1. <u>Recommendation: "Compensation Discussion and Analysis" Section</u>

A "Compensation Discussion and Analysis" section would provide a much needed context for directors' decisions relating to executive compensation. By requiring a discussion of the objectives and elements of the company's compensation plans, investors will have greater insight into the mindset underlying board level compensation decisions. Numbers alone are of limited benefit to investors unless they are accompanied by a sufficient narrative to assess the quality of the board's decision-making process concerning executive compensation. The proposed rule would be considerably strengthened by requiring that filers discuss its compensation of executives in relation to alternatives. Understanding the extent to which a board evaluates alternatives to contracting with a particular executive or group of executives is critical to evaluating the board's independence from those executives.

A commitment to pay extraordinarily high compensation levels to an executive or management team when candidates of similar reputation and ability are available at a substantially lower cost suggests compensation decisions driven less by objective criteria than by the board's lack of independence from management. Executives are routinely rated, scored and evaluated in relation to each other and to various absolute measures of performance. An active market for executive talent exists and the extent to which a board evaluates a candidate's compensation demands in relation to market alternatives is a critical indicator of board independence.

Requiring that consideration of market alternatives be discussed could materially improve the quality of board deliberation on matters of executive compensation and encourage corporate directors to consider their actions in a broader economic perspective. Requiring companies to disclose the extent to which the board has considered alternative candidates for named executive positions would not materially increase the cost of compliance with Rule 402 (b). A company that chooses, for whatever reason, not to consider alternative candidates would be free to indicate as much. Some companies might conclude that a particular executive is indispensable to carrying out specific board objectives, and so choose not to consider alternative candidates. A statement that compensation levels are attributable to the board's conclusion that a particular candidate is considered critical to carrying out strategic business objectives and the board's supporting rationale would assist investors seeking to evaluate board independence and the quality of the board's long-range strategic thinking. A board level judgment that a particular individual is indispensable to the achievement of company business objectives would also presumably rise to the level of materiality and otherwise be subject to disclosure.

Alternatively, if a board considers alternative candidates and concludes that the services provided by a particular executive could not be secured at a substantially lower cost by an equally qualified candidate, a brief statement that the board has undertaken such an inquiry and so concluded would also be helpful to investors. Conversely, if a board concludes that an alternative candidate could provide the services for less but chooses nevertheless to retain an executive at a substantially greater cost, the board's decision and underlying rationale will likely be of great interest to investors.

The retention and compensation of executives is uniquely committed to the business judgment of a board's directors. A valid exercise of business judgment, however, must be the product of informed deliberation. A "Compensation Discussion and Analysis" section would provide new insight into the reasoning of corporate directors on executive compensation matters. By requiring discussion of the extent to which directors have evaluated market alternatives in reaching their compensation decisions, the proposal will further benefit investors by allowing them to evaluate the quality of decision-making underlying compensation actions that implicate a seemingly ever-increasing share of the company's earnings.

Corporate performance targets should be specified to authenticate the validity of the executive pay hurdle. Many companies consider their hurdles proprietary, disclosure regulations should mandate shedding light on the hurdles. Astonishingly, shareholders don't know how incentivized or challenged an executive has been. This begs the question whether a CEO is just riding an industry or market wave or if the CEO is adding value.

2. Recommendation: Cap Executive Pay at 1.5X Executive V.P.'s Pay

CEOs at 2,000 of the largest U.S. companies have registered the following median compensation and increases over the last three years:[5]

Fiscal Year	Median Increase	Median Total Compensation $Million (MM)	S&P 500 Return
2004	30.2%	$2.4 Million (MM)	10.9%
2003	15.0%	$1,9MM	28.7%
2002	9.6%	$1.6MM	-22.1%

There is no justification for a 30.2% 2004 wage rise, when the S&P 500 returned only 10.9% or the 9.6% rise in 2002, when the S&P plunged -22.1%. This is a negative sum game, in which CEOs are taking away more value than they contribute. The return on investment for CEO pay is unacceptable.

Goldman Sach's CEO Henry Paulson was just provided with $38.3MM for 2005, a 28% raise over 2004, even though the stock rose only 24%. Even though Morgan Stanley's

[5] The Corporate Library/Board Analyst, http://www.boardanalyst.com/index.asp?p=researchcenter.

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equity was down 40% over five years, its CEO Phillip Purcell received a 47% raise to $22.5MM for his final year of service, terminating in June 2005, with a $113.7MM departure package. Lucent's CEO Patricia Russo was paid $33MM in compensation over three years, despite Lucent's 55% decline in market cap since she became CEO in 2002. Citigroup's ex-Chairman/CEO, Sanford I. Weill, collected $21.5MM in total compensation in 2005. Meanwhile, Citigroup's stock has bounced between $45.00 and $50.00 for the past two and one half years. The list continues. CEOs are paid outrageous salaries, despite no tangible benefits to shareholders.

In 2004, the ratio of average CEO pay to the average pay of a production worker was 431-to-1.[6] John Pierpoint Morgan once said that he would "never lend money to a company where the highest-paid employee was paid more than 20 times the lowest-paid," as it was in his view unstable. This ratio remained untouched throughout the late 1950's. This figure steadily climbed to its peak in 2001, when the average ratio of average CEO pay to the average worker pay reached 525-to-1.

J.P. Morgan's 20-to-1 metric might be too radical at this juncture, but it is time to cap CEO salaries. The Commission must intervene to stop corporate looting from equity investments. Firms could take a basket of senior managers, perhaps vice presidents, and apply a multiplier (e.g., 1.5X) to their average pay to arrive at the CEO's pay.

3. Recommendation: Disclosure of all Compensation—The Commission Should Provide a *de minimis* Exception for Inadvertent Omission of Immaterial Items of Disclosure

Compensation disclosure of all named executive officers is necessary in order for investors to evaluate compensation information among various issuers and from year to year at a single issuer. Since, however, the focus of the integrated disclosure system for both registrations under the Securities Act of 1933 and periodic reports and proxy statements under the Securities Exchange Act of 1934 is based on providing investors with material information, *de minimis* inadvertent omissions should not expose the issuer or its certifying officers to Commission action or liability. I encourage the Commission to formulate an exception to the disclosure requirements for immaterial items.

[6] United for a Fair Economy and the Institute of Policy Studies, http://www.ips-dc.org/projects/execexcess2001.htm.

B. Structuring Disclosure Proposal

1. Proposed Disclosure Requirement is Unclear and Difficult to Implement

Rule 3b-7 defines "executive officer" as a registrant's:

> president, any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant.[7]

If an officer performs a policy making function or any person performs similar policy making functions for the registrant, such person, by definition, is an "executive officer." If a person is an "executive officer," such a person is already subject to extensive executive compensation disclosure. The Commission now proposes to create, for disclosure purposes, a new class of employees who are not executive officers but "who exert significant policy influence by having responsibility for significant policy decisions."[8]

Determining whether an employee is an "executive officer" of a registrant is itself no simple task, and indeed has been the subject of extensive litigation in other contexts.[9] In light of the existing difficulty determining which employees are executive officers, it seems inappropriate and unworkable to compel registrants to attempt to sub-classify those employees who are not responsible for a policy making function. It is also unclear why the existing definition of "executive officer" does not encompass employees who have responsibility for significant policy decisions. Determining whether an employee exerts a policy-making influence would call for a highly factual, and ultimately subjective, analysis that would be exceedingly difficult for registrants. "Influence" depends upon a myriad of factual matters, including shifting personal relationships of which management may not even be completely aware.

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[7] 17 C.F.R. Section 240.3b-7.

[8] *See* Reproposing Release, 71 F.R. 53268. In the course of two succeeding paragraphs in the Reproposing Release, the Commission, without explanation, uses three different formulations for the new class of potentially disclosable employees: (i) "employees [that] exert significant policy influence;" (ii) "highly compensated policy-makers"; and
(iii) employees "who exert significant policy influence by having responsibility for significant policy decisions."

[9] *See* Merrill Lynch. Pierce, Fenner & Smith, Inc. v. Livingston, 566 F.2d 11 19 (9th Cir. 1978); Colby v. Klune, 178 F.2d 872 (2d. Cir. 1949); Jammies International v. Nowinski, 700 F.Supp. 189 (S.D.N.Y. 1988).

Given the lack of clarity and precision in the proposed disclosure standard, there is a strong likelihood of inconsistent application, significantly diminishing the usefulness of the standard for investors because of lack of comparability across registrants. The proposed rule would be exceedingly difficult for registrants to interpret and implement and would not provide investors with comparable information among various registrants. Accordingly, the Commission should not adopt the proposed rule as it has been drafted.

2. Recommendation

If the Commission is going to proceed with the proposed regulation, employees with no responsibility for significant policy decisions within the company, a significant subsidiary of the company or a principal business unit, division or function of the company should not be included when determining the three employees for purposes of this requirement. Responsibility for "significant policy decisions" could consist of, for example, the exercise of strategic, technical, editorial, creative, managerial or similar responsibilities. The Commission has cited specific examples of employees who might not be executive officers but who might have responsibility for significant policy decisions, e.g., the director of the news division of a major network; the principal creative leader of the entertainment function of a media conglomerate; or the head of a principal business unit developing a significant technological innovation.[10] By contrast, the Commission has also cited examples of employees who would not be affected by the proposal because, although they are highly compensated, they do not have responsibility for significant policy decisions, e.g. a salesperson, entertainment personality, actor, singer, or professional athlete.[11]

C. Compensation Calculation

1. The Three Most Highly Compensated other Executive Officers Should be Based on Salary and Bonus and not on "Total Compensation"

Disclosure for up to three highly compensated employees who are not executive officers should not be required. This disclosure would not provide meaningful information to investors, but would instead disclosing possibly sensitive, competitive information. An issuer's PEO and PFO should always be included as named executive officers in the Summary Compensation Table (Regulation S-K 302(a)(3)). Regardless of their level of compensation, the PEO and PFO are the critical officers of any issuer, certifying financial and other disclosure, and disclosure of their compensation is meaningful to investors' analysis of the issuer and the performance of the members of the board of

[10] *See* 17 CFR Part 229.

[11] *See id.*

directors of the issuer standing for election. I do not believe that adding other officers by title or job function alone adds meaningful information to investors. For example, disclosing the compensation of a general counsel, who is not otherwise among the top five most highly compensated executives, simply based on the position, would not provide material information to investors.

The identification of the remaining three NEOs under the Commission's proposals would be determined based on "total compensation" rather than on salary and bonus. If "total compensation" is determined as currently proposed (by aggregating the dollar values of the proposed remaining columns), the amount will include such items as the total value of non-vested multi-year stock and non-equity awards. Increases in value of pension benefits and deferred compensation, and other items which are subject to annual variations which may not be tied to the executive's basic compensation for the year but rather to whether it is a grant year in a plan cycle, the executive's ability to defer income or the executive's age. While the value of other compensation is very significant, salary and bonus (inclusive of any amounts deferred by the executive) continue to be the leading indicators of an executive's perceived importance to the issuer.

The proposal also would add to the compensation disclosure the total compensation and job descriptions of up to three employees who are not executive officers but whose total compensation for the year exceeded that of any of the NEOs.[12] The proposal indicates that this disclosure is designed to alert investors about the use of corporate assets to compensate individuals but would not require disclosing their names since they are not in policy making functions. This additional information does not add materially to the total mix of information available to investors. Compensation expense for an issuer, as well as other expenses of its business, is disclosed in the financial statements. If the goal of the additional disclosure were to identify individuals or jobs within an issuer which are critical to its success, as measured in part by the high compensation paid by the issuer, the disclosure might be more useful as a risk factor disclosure in the Form 10-K where the nature of the contribution of the individual to the success of the issuer can be explained. Simply to disclose total compensation and job descriptions seems likely to result in disclosures which may be competitively disadvantageous to certain issuers, inconsistent from year-to-year, and require significant additional record keeping (since the elements of "total compensation" cannot be determine solely by looking at a W-2).

[12] Proposed Regulation S-K Item 402(f)(2).

2. Recommendation

The annual value of defined benefit plans, defined contribution plans and nonqualified deferred compensation arrangements should be excluded from the "All Other Compensation" column of the Summary Compensation Table:

- It is difficult to present a meaningful annual value for these benefits because their value is often a function of several dynamic components and these benefit amounts are earned over an executive's entire career.
- Including these benefits in the "All Other Compensation" column will result in significant annual fluctuations in the amounts disclosed in this column from year-to-year, will lead to significant volatility from year-to-year, and will produce anomalies in reported compensation that will confuse, rather than enlighten, shareholders.
- These benefits represent wealth accumulation and their values would be better disclosed in the appropriate post-employment-related tables.

3. Alternative Recommendation

If the Commission decides to include the annual value of these benefits in the Summary Compensation Table, these amounts should still be excluded from the determination of a company's most highly-compensated executive officers, both to reduce the administrative compliance burden and to maintain year-to-year consistency. In the alternative, however:

- The disclosure of investment earnings on nonqualified deferred compensation and nonqualified defined contribution plans should be limited to investment earnings that are paid or accrued at "above market" or "preferential" rates;[13] and
- The disclosure of the annual increase in the value of defined benefit retirement plans should exclude the effects of interest that simply represents the fact that the benefit is payable one year sooner. The required disclosure should reflect the increase in value attributable to an additional year of service and/or compensation increases, and not the mere passage of time.

These changes are appropriate because investment earnings are not compensatory in nature because the annual increase at a market rate merely reflects the time value of money.

[13] For these purposes, "above-market" or "preferential" earnings would be defined as currently provided in Instruction 3 to Item 402(b)(2)(iii)(C).

D. Limiting Covered Entities to Large Accelerated Filers

Modifying the proposed rule to apply only to large accelerated filers[14] would properly focus this disclosure obligation on companies that are more likely to have these additional highly compensated employees. This modification would address concerns that the proposed rule would impose disproportionate compliance burdens by limiting the disclosure obligation to companies that are presumptively better able to track the covered employees.

A large accelerated filer is an issuer that:

- has an aggregate worldwide market value of voting and nonvoting common stock held by its non affiliates of at least $700 million, calculated as of the last business day of the issuer's most recently completed second fiscal quarter;
- has filed at least one annual report under the Securities Exchange Act of 1934;
- has been subject to the periodic reporting requirements of the Exchange Act for a period of at least 12 calendar months; and
- is not eligible to file periodic reports as a "small business issuer."

Recommendation

By imposing the obligation to provide compensation information for up to three employees compensated more than the executive officers, the Commission's concerns are that the proposed rule "would impose disproportionate compliance burdens by limiting the disclosure obligation to companies that are presumptively better able to track covered employees."[15] I disagree with this limitation for two reasons: first, if the Commission is correct in assuming that large, accelerated filers are more likely to have these types of employees, then it does not impose any additional burdens on or create hardships for smaller companies and second, larger companies that have an easier time complying with disclosure requirements generally coincide with less-risky investments, thereby decreasing the need to protect investors.

E. Materiality of Proposed Information to Investors

Some commenters question the materiality of the information required by the proposal, given that the affected employees would not be in policy-making positions like executive officers.[16] The issues raised by these commenters demonstrate the concern

[14] The term large accelerated filer is defined in Exchange Act Rule 12b–2 [17 CFR 240.12b–2].

[15] *See* Release, at 53,268 (indicating concern raised by requiring all companies to comply with additional disclosure obligations).

[16] See, *e.g.*, letters from California State Teachers' Retirement System; Cleary; CNET Networks; Compass Bancshares; DreamWorks; Entertainment Industry Group; Fried, Frank, Harris, Shriver & Jacobson LLP;

about disclosure regarding employees, particularly within very large companies, whether or not they are executive officers, whose total compensation for the last completed fiscal year was greater than that of one of the named executive officers. The Commission posits that this disclosure "should assist in placing in context and permit a better understanding of the compensation structure of the named executive officers and directors."[17] The Commission does not adequately explain, however, why the Compensation Disclosure and Analysis (that companies will be required to provide beginning in 2007) will not be sufficient to put into context and elaborate upon the compensation structure of the named executive officers.[18]

Recommendation

Several key points relating to the materiality of the subject information should be considered:

- The amounts involved are unlikely to be material from a financial perspective. If the amounts are material, they should be covered in the Management's Discussion and Analysis of Results of Operations and Financial Condition pursuant to Item 303 of Regulation S-K. The Commission has not explained why this category of expense (non-executive employee compensation expense), should be disclosed separately.
- The compensation of the non-executive employees does not implicate corporate governance matters. In general, compensation committees do not set the compensation of the non-executive employees, which is instead set by management in response to market forces. The Commission has not asserted in the Proposing or Reproposing Releases, nor does the administrative record establish, that there are any conflicts of interest or other corporate governance concerns inherent in setting non-executive compensation.
- The non-executive employees whose compensation would be disclosed would vary from year-to-year. The lack of continuity in this disclosure would occur because the compensation of non-executive employees frequently is influenced

FSR; Hewitt Associates LLC; ICI; Intel; Kellogg; Kennedy; Leggett & Platt; Peabody Energy; Pearl Meyer & Partners; SCSGP; SIA; Stradling Yocca Carlson & Rauth; Top Five Data Services, Inc.; Towers Perrin, dated April 10, 2006;
and Walden Asset Management.

[17] *See* Reproposing Release, 71 F.R. 53268.

[18] "The [Compensation Discussion and Analysis] will be an overview providing narrative disclosure that *puts into context* the compensation disclosure provided elsewhere . . . . The purpose of the Compensation Discussion and analysis is to provide material information about the compensation objectives and policies for named executive officers." Securities Act Release 33-8732A (September 8, 2006), 71 F.R. 53 164 (emphasis added).

by an extraordinary or non-recurring payment, such as a one-time award upon joining the company or a bonus for a particular event. As Institutional Shareholder Services stated in its comment letter, "these three individuals may change each year depending on their total compensation figures. The lack of continuous and consistent disclosure further dilutes the need for such information."[19]

F. Privacy Issues

The proposed rule raises privacy issues and may negatively impact competition for employees in a manner that would outweigh the materiality of the disclosure to investors.

1. Invasion of Privacy and Undermined Employee Morale

The proposed rule would constitute an unwarranted intrusion into the personal privacy of employees. In the United States, information concerning compensation is generally considered personal and confidential. Indeed, many areas of our laws—tort law, the Freedom of Information Act and discovery laws—recognize that employees have a reasonable expectation of privacy in their compensation information.

When the Commission first began requiring individual compensation disclosure of a small subset of executive officers, it did so because of the prevailing belief that greater disclosure would strengthen corporate governance functions at both the shareholder and director levels.[20] Essentially, the perceived public benefits of enhanced disclosure were deemed to outweigh the detriment to the affected individuals. As discussed above, compensation disclosure of non-executive employees does not implicate corporate governance concerns. In this instance, the hypothetical benefits to stockholders from public disclosure of non-executive compensation pale in comparison to the real harm to employees from disclosure of sensitive compensation information.

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[19] Letter from Martha L. Carter, Ph.D., Senior Vice President and Managing Director -Corporate Governance, Institutional Shareholder Services to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, (March 28, 2006).

[20] The Commission adopted major reforms to executive compensation disclosure in 1992. &*Executive Compensation Disclosure,* Securities Act Release 33-6962 (Oct. 16, 1992), Fed Sec. L. Rep (CCH) fi 85,056. In adopting the 1992 revisions, the Commission was reacting to the perceived "deficiency in the structure of corporate governance that must be rectified." Lowenstein, *ReJlections on Executive Compensation and a Modest Proposal for (Further) Reform,* 50 SMU *L.* Rev. 20 1, at *2 15-2 16 (Sept./Oct. 1996); see also Keller, *Executive Compensation Disclosure, in Executive Compensation Reporting 1993: Living with the New Rules* at 15- 16 (PLI 1993) (one of the premises of the 1992 rules is that improved disclosure of executive compensation would result in "strengthening the exercise of corporate governance at both the shareholder and director levels").

The Commission also asks whether it should require that the three additional employees be named. This requirement would constitute an even greater invasion into the employees' privacy. Whether the disclosure is accompanied by specific names or a description of the employee's function, the most avid readers of this disclosure are likely to be fellow employees. This will significantly undermine employee morale because compensation information of non-executive officers is generally not disseminated within an organization and employees will seek to match the compensation of the disclosed individuals.

2. Jeopardize the Ability to Retain Key Employees

Non-executive compensation disclosure would jeopardize a company's ability to retain key employees. Competition for many employees is intense. The compensation disclosure of certain non-executive employees would give companies' competitors a material advantage in competing for employees by providing access to this highly sensitive and confidential information.[21] The Commission's modification of the proposal to limit disclosure to employees with responsibility for significant policy decisions does not ameliorate this concern.

3. Recommendation

To the extent that commenters have opposed the disclosure because it could result in a competitor stealing a company's top ''talent,''[22] the Commission should address these concerns by focusing the disclosure on persons who exert "significant policy influence within the company or significant parts of the company."

G. Definition of ''Responsibility for Significant Policy Decisions''

If the Commission adopts the proposed rule, it should modify the test used to describe employees who exert a significant policy influence on a given company.

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[21] Certain of the Company's primary competitors operate as divisions or units of business organizations that are much larger than the Company. As a result, the Company's competitors may not be required to make similar disclosures with respect to comparable employees.

[22] See, *e.g.*, letter from Entertainment Industry Group. In addition, my intention is not to suggest that these additional employees, whether or not they are executive officers, are individuals whose compensation is required to be reported under the Exchange Act ''by reason of such employee being among the 4 highest compensated officers for the taxable year,'' as stated in Internal Revenue Code Section 162(m)(3)(B) [26 U.S.C. 162(m)(3)(B)]. See letter from Cleary (expressing concern that the additional individuals not fall within the purview of Section 162(m) of the Internal Revenue Code).

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1. Recommendation: Link "Responsibility for Significant Policy Decisions" to "Policy-Making Authority"

If the Commission adopts the proposed rule, it would behoove shareholders for the new disclosure standard to be based upon whether the non-executive employee has "policy making authority" rather than whether the employee exerts a "policy making influence." A test based upon "policy making authority" would be easier to administer because the company knows which employees have authority over various substantive areas. Conversely, whether an employee is "influencing" policy would be exceedingly difficult to administer. Determining whether an employee exercises policy making "influence" would require a registrant to make a highly subjective determination based upon shifting personal relationships and other potentially ambiguous factual matters. The certifying officers would have personal exposure for the accuracy of these determinations.

2. Reference Group for Non-Executive Employees

The Commission proposes to require disclosure of the compensation of registrants' three most highly compensated employees, whose total compensation for the last year was greater than that of any of the named executive officers. From time to time, CEOs and other corporate officers receive zero or nominal compensation for a variety of reasons. Although reduced compensation arrangements are not standard industry practice, they are not unprecedented.[23] In some cases, corporate executives take zero cash compensation and in other cases they may take no compensation at all in a given year. In any event, it is undeniably in the interests of shareholders for executives to enter into these arrangements when they are willing to do so. The proposal is written in such a way that, where CEOs or other executives receive zero or nominal compensation, it could increase the number of non-executive employees for whom disclosure must be provided. This is an unfair result to these issuers and particularly to the employees whose privacy interests are being compromised by the disclosure in question.

3. Recommendation

Although there may be a variety of ways to address these anomalous situations, I believe that the appropriate manner is to exclude the compensation of the principal executive officer and principal financial officer in determining the compensation

[23] For example, the principal executive officers of Alexander's, Inc., Apple Computer, Inc., Capital One Financial Corp., Duke Energy Corporation, ENESCO Group, Inc., Ford Motor Co., Fossil, Inc., Global Signal, Inc., Hospitality Properties Trust, Kinder Morgan, Inc., Kinder Morgan Energy Partners L.P., Salesforce.com, Inc., Thornburg Mortgage, Inc., Univision Communications, Inc. and USANA Health Services, Inc. received no salary or bonus for their respective 2005 fiscal years.

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threshold for disclosure of non-executive officer compensation. The PEO and PFO are included as NEOs without regard to their respective levels of compensation. Thus, it would be more equitable to key disclosure of non-executive employees to the other NEOs (e.g., excluding the PEO and PFO), since they are designated as NEOs not solely on the basis of their positions but rather also on the level of their compensation.

H. Required Information Regarding Employee's Compensation or Job Position

I strongly support the Commission's goal to improve disclosure of the elements of executive compensation. The unintended consequences include an increase in the cost of attracting and retaining key employees. Moreover, the proposed provisions could have the additional unintended consequence of creating a competitive imbalance in the market place. The new disclosure could make it more difficult for public companies to seek and retain key employees when private companies do not have to make the same proposed disclosure filings. Many industries are competing for the same non-policy making, but highly compensated, key personnel. It is difficult to conceive of how shareholders and investors of public companies could benefit from the competitive disadvantage inherent in requiring that this information be disclosed.

Disclosing the compensation of three individuals who are non-executive officers gives anecdotal information to investors, but does not inform them in any analytically meaningful way. These individuals are not "policymakers" in the sense that they direct payment of their own salaries, so self-dealing is not at issue. The compensation of these individuals depends on market forces; is usually short term focused (e.g., percentage of earnings or some other index); and can fluctuate dramatically from year-to-year. This absence of continuous and comparable disclosure further dilutes the relevance of such information.

Disclosure of the salaries of certain highly compensated individuals will be of little or no use to investors but is likely to cause real competitive harm. Compensation is market-based and highly competitive. Under the current proposal, the identity of the three unnamed individuals would not be disclosed in the proxy statement, but it is highly likely that other employees within the firm and competitors will be able to "pick off" key employees. This is apt to increase demands for higher compensation within firms by similarly-situated employees who are not as highly compensated. It also will provide an open opportunity for competitors to bid highly productive employees away from the company, leading to an overall higher compensation cost. Moreover, many key employees maintain strong, personal relationships with their clients based on the clients' trust in the employee, and the departure of these key employees could cause the loss of clients, which could have an adverse effect on the company.

Furthermore, in some companies, the salaries of many key, but non-policy-making, employees are "confidential" as a condition of employment and as a matter of contract.

Disclosing these compensation agreements would violate previously agreed upon privacy rights and contractual provisions. The proposed rule would create a competitive imbalance in the markets by putting public companies at a disadvantage with regard to their private sector peers.

Recommendation

The Commission should consider amending and narrowing the proposed rules:

- Include only those persons who are policy makers with authority to effect corporate, entity-wide decision making.
- Apply disclosure requirements to encompass employees of the parent company but not operating subsidiaries as they do not exercise policy decisions on an entity-wide basis.
- Apply newly required provisions prospectively following the provision's adoption by the Commission for the corporations' next complete fiscal year's report but in no event earlier than 2007 fiscal year end filings
- Allow for exemptive relief for those firms that have contractual privacy agreements with key employees.

I. Cost Estimates

The collection and analysis of this information will be costly. While there is an established collection framework and most public firms have executive compensation committees, these mechanisms and infrastructure do not exist for collecting and analyzing the salaries of three other non-executive employees. Public firms would have to construct a new analytical framework to collect and evaluate these salaries. Even then, this information would not necessarily provide shareholders with the comparative, long-term information normally reported and which is so necessary to align executive salaries with corporate performance.

For some large accelerated filers, the number of employees potentially subject to this requirement may already be known or easy to identify. Other, more complex companies may need to establish systems to identify such employees. Every large accelerated filer would need to evaluate whether any employees exerted significant policy influence at the company, at a significant subsidiary or at a principal business unit, division or function and would have to track their compensation in order to comply with the proposed requirement. These monitoring costs may be new to some companies. The cost of actually disclosing the compensation would be incremental and minimal. The monitoring and information collection costs are likely to be greatest in the first year and significantly less in later years. Costs would largely be borne internally, although some companies may seek the advice of outside counsel in determining which employees meet the standard for disclosure.

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Approximately 1,700[24] companies will on average retain outside counsel for eight hours in the first year and two hours in each of two succeeding years, at $400 per hour, for a total estimated average annual cost of approximately $3 million.[25] Assuming all large accelerated filers spend sixty hours in the first year and ten hours in each of the two succeeding years, with an average internal cost of $175 per hour, the total average annual burden of collecting and monitoring employee compensation would be approximately 45,000 hours, or approximately $8 million.[26] The total average annual cost is therefore estimated to be $11 million.[27]

VII. Summary

In summary, I believe the Commission's enhanced disclosure requirements should help to curb abuses and slow the pace of accelerating executive pay, thereby strengthening public confidence in the governance of listed companies and the fairness of our financial markets. I believe profoundly that full and fair disclosure must continue to be the hallmark of our nation's commitment to shareholder protection, not only because it informs the investing public, but because such disclosure will ultimately modify egregious behavior by executives.

I hope that these comments are useful and I would be happy to discuss the aforesaid views in greater detail. Thank you for your consideration.

Respectfully submitted,

Anthony D. Foti

[24] *See Revisions to Accelerated Filer Definition and Accelerated Deadlines for Reporting Periodic Reports*, Release No. 33–8644 (Dec. 21, 2005) [70 FR 76626], at Section V.A.2.

[25] *See* 17 CFR Part 229.

[26] *See id.*

[27] *See id.*

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