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May 15, 2006

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-9303

Re: File No. S7-03-06
Release No. 33-8655; 34-53185
Executive Compensation and Related Party Disclosure

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the American Bar Association, Section of Business Law (the "Committee") in response to the request by the Securities and Exchange Commission (the "Commission") for comments on proposed amendments to the disclosure requirements for executive and director compensation, security ownership of officers and directors and related matters (the "Proposals") set forth in the release described above dated January 27, 2006 (the "Proposing Release").

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committee.

Overview

We welcome and support the Commission's decision to revisit its rules addressing disclosure requirements for executive and director compensation, security ownership of officers and directors and related matters. We 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 14 years and have established a framework that can and should be largely continued. However, we also agree that it is appropriate to revisit some of the policy decisions and resulting disclosure standards that – either intentionally or unintentionally – were built into the existing rules and 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 incentivized and what is management gaining from the entity as a result. We 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.

Efforts to address executive compensation disclosure requirements also serve to demonstrate the complexity of this issue. As noted above, we believe that the existing disclosure rules have proven remarkably resilient in accommodating the presentation of a wide variety of pay practices and forms of compensation over a broad spectrum of registrants and over time. Nevertheless, any effort to revisit the disclosure rules quickly demonstrates that seemingly simple questions can have multifaceted responses: When was a particular form of compensation paid? How should it be valued? What was it paid for? It would be impossible to draft a set of rules that could accommodate the breadth of these issues and encompass every possible form or variation of compensation arrangement while achieving the goal of comparability in presentation. The rules should instead recognize that in many cases the answers to these questions are complex and not uniform across all registrants or all elements of pay.

Our comments below generally support the Commission's proposals to expand and enhance the disclosure of director and executive compensation, security ownership of officers and directors and related matters. In light of the considerations set forth above, in only a few instances have we questioned the appropriateness of proposed disclosures. In most cases, we 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. We also provide a number of technical comments so that the rules accommodate or reflect actual practice. In making these comments, three broad themes underlie our 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.

Principal Comments

Our principal comments are summarized below. These and other comments are discussed in more detail in the following sections of this letter.

1. The proposed Compensation Discussion and Analysis 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 Named Executive Officers other than the Principal Executive Officer.

2. The Summary Compensation Table should present information on a consistent, articulated basis, should not include deferred compensation plan earnings unless those earnings are preferential and should not include pension plan accruals. Disclosures related to deferred compensation plans and pension plans should be set forth only in the tables tailored to those disclosures.

3. Incentive plan awards should be reported on a consistent basis throughout the tables and should be categorized based on whether they are equity-based or not equity-based.

4. Modifications of outstanding stock options should not be treated as a new grant by requiring full fair value disclosure but should instead be reported on the basis of FAS 123R-determined incremental fair value increase.

5. Disclosure should not be required of compensation paid to non-executives.

6. The Commission should refine its interpretive guidance addressing identification of perquisites to focus upon the extent to which arrangements provide personal benefits.

7. The determination of those Named Executive Officers 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 Named Executive Officers.

8. The value of pension, change-in-control and post-employment benefits should all be calculated as of the end of the last completed fiscal year. The relevance of the

disclosures will be increased if they reduce the extent to which companies must apply assumptions, projections and hypotheticals.

9. Proposed changes to Form 8-K reporting are appropriate but could be refined to further reduce the number of filings reporting routine compensation actions that are not "unquestionably and presumptively material" and instead provide for some of those disclosures in Forms 10-Q.

<u>Detailed Comments Regarding the Proposal</u>

I. Compensation Discussion and Analysis ("CD&A")

For the reasons discussed below, we believe that the CD&A should be a report of the board compensation committee[1] that is "furnished" to the Commission. The rules governing the CD&A should be clearer as to whether only compensation policies and principles are to be addressed or whether, as we believe is preferable, the report is also to address the bases for the actual compensation reported. To the extent that the actual bases for reported compensation are to be addressed, the rules should specifically reaffirm that the report is not required to address subjective individual performance assessments for Named Executive Officers ("NEOs") other than the Principal Executive Officer ("PEO"). The rules should allow detailed discussions of actual compensation payments even if the information may be repetitive of narrative disclosures that accompany the tables, should be less normative by reaffirming that a topic needs to be discussed only to the extent applicable and material, and should be revised to eliminate aspects of the Proposals that likely will lead to boilerplate disclosures.

A. Status of the CD&A as a Filed Report of the Company

To address increased investor interest in and scrutiny of executive compensation decisions and to facilitate investors' focus on executive compensation in the context of corporate governance, we support the Commission's proposal to expand and enhance the discussion of compensation beyond what is currently required in the Board Compensation Committee Report on Executive Compensation ("BCCR"). We acknowledge that the current disclosure requirements for the BCCR do not address much of the information that investors wish to know about the processes and bases for setting executive compensation. As discussed below, we do not believe that this is the consequence of – or is affected by – the report's status as either a filed report by the company or a furnished report by the compensation committee, but instead arises from the extremely abbreviated nature and scope of the disclosure requirements currently set forth in Item 402(k). Many BCCRs in fact are quite expansive and detailed when one considers that the substantive disclosure requirements for the BCCR set forth in Item 402(k) consist of a mere three sentences – one of which requires information on "compensation policies applicable to the registrant's

[1] Throughout this comment letter, references to the "compensation committee" include the board committee performing equivalent functions or, in the absence of such a committee, the entire board of directors.

executive officers" with particular focus on "the specific relationship of corporate performance to executive compensation" and two of which require information on the factors and criteria affecting the PEO's compensation.

There are significant benefits to retaining the status of the discussion on executive compensation as a report of the board's compensation committee. Making it a company report risks diluting the control of directors over the disclosures, which is at odds with current best practices and trends in corporate governance. Through its 1992 rule changes, the Commission established the principle that the directors responsible for overseeing a registrant's executive compensation program should be capable of and willing to stand behind the report.[2] At that time, the Commission's stated reason for requiring that the BCCR be made over the names of the compensation committee members was to increase their attention to the specific disclosure obligation.[3] The compensation committee's existing responsibility for the BCCR, corporate governance best practices and listing standards of the stock exchanges have over the years aligned so that investors now view the BCCR as their primary window into the compensation committee and the directors' decisions in setting compensation. The proposed change would disrupt this accepted relationship between investors and directors, and thereby frustrate shareholder expectations.

Further, the change appears to run counter to the recent corporate governance trend of disengaging executive officers from the decision-making role in determining executive pay. For example, both the New York Stock Exchange and NASDAQ have adopted rules requiring the board compensation committee either alone or with the board to be responsible for the PEO's compensation and for the compensation of other executive officers. Under these rules, the PEO's compensation is decided in an executive session in which the PEO does not participate and from which other company officers and employees are typically excluded.[4] Similarly, the New York Stock Exchange's corporate governance standards stipulate that the board

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[2] We recognize that a company's executive compensation policies are typically not directly attributable to the directors serving on a board compensation committee at any one point in time, because a company's compensation philosophy and policies tend to be developed and maintained over time, while the membership of board committees typically changes periodically. Nevertheless, we believe that directors who serve on compensation committees understand and accept the responsibility for overseeing the preparation and content of the report.

[3] Executive Compensation Disclosure, Exchange Act Rel. No. 31327 (Oct. 16, 1992) (the "1992 Adopting Release"), at part II.H. ("The Commission continues to believe that disclosure of the Compensation Committee's policies will enhance shareholders' ability to assess how well directors are representing their interests, and thus is an appropriate and necessary improvement to the disclosure concerning executive compensation in the proxy statement clearly within the Commission's authority.... The signature requirement was intended simply to increase the Committee members' focus on the specific disclosure obligation. The requirement that the report be made over the names of the Committee will accomplish the same purpose and avoid the practical difficulties involved in obtaining manual signatures.")

[4] NYSE Listed Company Manual Rule 303A.05(b)(i)(C); NASDAQ Rule 4350(c)(3) ("The chief executive officer may not be present during voting or deliberations.")

compensation committee must establish and maintain a charter that addresses the committee's direct responsibility for producing a compensation committee report on executive officer compensation to be included in a listed company's annual proxy statement or annual report on Form 10-K.[5]

If the discussion of executive compensation becomes a report of the company and therefore is required to be certified by the PEO and the principal financial officer ("PFO"), those individuals will need greater access to and knowledge of the compensation committee's considerations and process in order to provide a basis for certifying to the best of their knowledge that the CD&A does not omit to state a material fact. This comment should not be read to suggest that BCCRs do not currently satisfy this standard. As was the case prior to adoption of the officer certification requirements and as remains the case with company disclosures that are not required to be certified by the PEO and PFO, such as disclosures on Form 8-K, companies remain subject to a general antifraud standard that accompanies their public disclosures, particularly in documents filed with or furnished to the Commission, whether or not those disclosures are covered by the officer certifications. We believe that companies are mindful of that obligation in the context of the BCCR, particularly in the light of increased litigation over BCCR disclosures. Thus, we believe the issue involved in considering this aspect of the Proposals is not the accuracy of the CD&A, but instead is the extent to which the CD&A will be subjected to PEO and PFO due inquiry, disclosure committee discussions and other diligence processes that are generally applied to disclosures covered by the certifications.

For example, to discharge their responsibilities attendant to making the required certification, the PEO and PFO will have to make due inquiry of the board compensation committee, including inquiries into the decisions of the board compensation committee about specific decisions affecting the PEO's and PFO's own compensation and, in the case of the PFO, the compensation of his or her peers and superiors at the company. At best, this will be an awkward situation and, at worst, the procedures that these executives establish to satisfy their responsibility over appropriate disclosure controls may impact a compensation committee's decision-making process and substantive decisions. The PEO and PFO will have a legitimate basis for commenting on and suggesting revisions to the CD&A, which may tend to mute the potential for otherwise robust or candid disclosures. We believe that this is an unintentional but inappropriate consequence of the Proposals that runs counter to the corporate governance goal of making directors more directly accountable for executive compensation decisions.

As stated above, we do not share the Commission's view that the quality of BCCR disclosures has been – or that the quality of the CD&A will be – negatively impacted by it being a furnished report of the compensation committee instead of filed report by the company. We believe that the proposed expansion of the scope and specificity of the rules as to the matters to be discussed will have a more direct impact on the quality of disclosures than changing the disclosure's status from being furnished to filed. In contrast, making the CD&A a filed report of the company

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[5] NYSE Listed Company Manual Rule 303A.05(b)(i)(C).

instead of a furnished report of the compensation committee may lead to more formalistic and less candid discussions, not as a result of the distinction in liability between a filed and furnished document, but as a result of eliminating attribution to and accountability by the committee and interjecting the PEO and PFO more into the disclosure process.

If the Commission nevertheless determines to treat the CD&A as filed, it should expressly exempt the CD&A from being covered by the PEO and PFO certifications requirements of Exchange Act Rules 13a-14 and 15d-14, in order to avoid the disjunctures discussed above between responsibilities for the matters being reported on and responsibilities for the disclosure.

In addition, if the Commission decides to treat the CD&A as filed, the final rule should expressly confirm that any financial measures used by the compensation committee to determine the compensation paid to NEOs and discussed in the CD&A will be treated as a measure of operating performance, a statistical measure or otherwise as a disclosure that falls outside the definition of a "non-GAAP financial measure." It is very common for compensation committees to base compensation on performance measures that are not calculated in accordance with GAAP. When compensation committees are disclosing these performance measures, they are not presenting them in a context that is intended to address the financial accounting results of the company; rather, they are presenting them as the basis for particular pay decisions. Treating these disclosures as being subject to the Commission's non-GAAP rules might improperly influence the measures that a compensation committee selects for purposes of evaluating performance in making compensation decisions. For example, if the proxy statement discussion of a financial performance measure that is not calculated in accordance with GAAP and that excludes a recurring item triggers the obligation to make extensive additional non-compensation related disclosures pursuant to Item 10(e) of Regulation S-K and to address each of the five topics set forth in Q&A 8 of the Staff's "Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures,"[6] a compensation committee might be less inclined to use such a measure as a basis for determining compensation and instead might base compensation on subjective determinations or non-financial operating measures.

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[6] Q&A 8 of the FAQ states that disclosure of a non-GAAP financial measure that excludes a recurring item "may be misleading absent the following disclosure:

- the manner in which management uses the non-GAAP measure to conduct or evaluate its business;
- the economic substance behind management's decision to use such a measure;
- the material limitations associated with use of the non-GAAP financial measure as compared to the use of the most directly comparable GAAP financial measure;
- the manner in which management compensates for these limitations when using the non-GAAP financial measure; and
- the substantive reasons why management believes the non-GAAP financial measure provides useful information to investors."

B. Scope of the CD&A

1. The Degree of Specificity Required in the CD&A

We support the principles-based approach taken in proposed Item 402(b) by enumerating disclosure concepts and providing illustrative examples. However, we believe that the extent to which the CD&A is required to address the actual bases for and factors affecting reported compensation is not stated as clearly as the Commission may intend. While a careful reading of proposed Items 402(b)(1) and (2) suggest that the CD&A should include a discussion of the specific factors and criteria upon which the PEO's and the other NEOs' compensation for the last completed fiscal year was based, the proposed rule text does not specifically state that. The first sentence under proposed Item 402(b)(1) requires a discussion of the compensation awarded to, earned by, or paid to the NEOs, but each of the six disclosure principles that are to be included in that discussion can be read to call for only a general discussion of the objectives, philosophy and design of the elements of compensation for the NEOs. Similarly, proposed Instruction 3 to Item 402(b) states that only the "material principles underlying the registrant's executive compensation policies and decisions" should be discussed in the CD&A and that the CD&A shall not discuss the actual compensation reported in the tables under Item 402 and should not discuss the factors upon which that compensation is based.

To clarify the intended scope of the CD&A, Item 402(b) should specifically require a discussion of the bases for and factors affecting the NEOs' compensation and should not prohibit or discourage discussions of the information disclosed in and accompanying the individual compensation tables. As with good Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") disclosures,[7] the CD&A would be more helpful and informative to investors if the regulatory text requires the CD&A to:

- begin with an overview of compensation policies and the elements of compensation that provides context for the remainder of the discussion;

- focus on material information and not require a discussion of immaterial factors that did not affect compensation policies or payments; and

- identify and discuss the material performance measures, including non-financial performance measures, that the compensation committee used to set compensation, subject to exceptions for competitively sensitive information and for individual subjective performance evaluations as discussed below.

We believe that the discussion of compensation policies and decisions will be more robust, and that it will assist in avoiding boilerplate, if the discussion is specifically tied into references to

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[7] *See* Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Rel. No. 8350 (Dec. 29, 2003).

and/or discussions of the specific amounts of compensation paid. For example, a statement that a particular element of compensation is designed to enhance stockholder value is given much greater meaning if tied to a discussion of how actual amounts paid varied with or were affected by changes in stockholder value. Because the line between a discussion of the principles underlying a compensation program and a separate discussion of the specific compensation awarded to, earned by, or paid to the NEOs is difficult to distinguish,[8] the final rule should delete the language from Note 3 to proposed Item 402(b) prohibiting discussion/repetition of the numerical and narrative information set forth in and accompanying the tables.

2. Discussion of NEO Compensation in the CD&A

We support the proposal to have the CD&A address only the material information necessary to understand the compensation of the NEOs, as opposed to addressing compensation policies affecting executive officers generally.[9] Likewise, we support the proposal to have the CD&A address the bases for each NEO's compensation, broadening the current BCCR requirement that requires a specific discussion only of the PEO's compensation. We believe these changes will assist in responding to investors' interest in greater information on the bases for compensation reported in the accompanying compensation tables.

However, in addressing the scope of the required discussion, it is important for the final rules to maintain and expressly reaffirm the current standard that individualized subjective factors affecting specific pay decisions for NEOs other than the PEO do not need to be disclosed to the extent they are not based on corporate performance. As with the proposed CD&A, the Commission's first 1992 proposal for the BCCR would have required disclosure of "the committee's decisions on, or approval of, awards and payments of cash and non-cash compensation disclosed under this section as having been granted or paid to, or earned by, each of the named executives in the last fiscal year."[10] As with the Proposals, the 1992 proposing

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[8] For example, it appears odd to call for the discussion of any waiver or modification of specified performance targets, goals or conditions in the text following a table, whereas the bases for any such waiver or modification would more appropriately fit into the CD&A. Likewise, some of the narrative proposed to accompany the Retirement Plan Potential Annual Payments and Benefits table under proposed Item 402(i)(3), such as the proposed discussion of registrant policies with regard to such matters as granting extra years of credited service, to the extent material and applicable, appears appropriate for discussion in the CD&A.

[9] In our experience, the fact that the BCCR is required to address compensation policies applicable to executive officers generally – as opposed to addressing only the material policies relevant to the reported compensation of the NEOs – is a source for much of the lack of specificity and generalized discussion in existing BCCR disclosures.

[10] Executive Compensation Disclosure, Exchange Act Rel. No. 30851 (June 23, 1992), at part II.5., stating:

> "Like the currently required management's discussion and analysis ('MD&A'), this report is intended to bring shareholders into the compensation committee or board meeting room and permit them to see and understand the specific decisions made through the eyes of the directors. In particular, disclosure will be mandated of the committee's (or board's or other committee's) consideration of the relationship of each

release analogized the proposed disclosure requirement to MD&A. Commenters objected to that proposal because of the suggestion that it would have required disclosure of subjective factors affecting the compensation of executives other than the PEO. The commenters emphasized the fact that public disclosure of subjective individual evaluations of performance can impair management's effectiveness by impacting the dynamics between executives, hindering the board's ability to develop and implement succession plans and affecting an executive's effectiveness in dealing with subordinates and with third parties.

In recognition of the legitimate concern expressed by the commenters in 1992 about application of the proposed MD&A-type disclosure to NEOs other than the PEO, the Commission revised the proposed requirement to limit the specific discussion to the PEO.[11] Instead of requiring a discussion of each factor affecting the compensation of each of the other NEOs, the rules adopted by the Commission in 1992 require a discussion of the compensation policies with respect to the registrant's executive officers, including the extent to which such compensation (in the aggregate) is performance-related, and the performance measures considered. While it may now be appropriate for the Commission to expand the scope of the rules to require a specific discussion of the material bases for each NEO's compensation, for the same reasons that were raised in 1992 and that continue to implicate legitimate concerns regarding internal corporate dynamics, the Commission should expressly confirm that the CD&A's discussion of the compensation of NEOs other than the PEO need not disclose subjective individual performance assessments.

The Commission can address this point by inserting a new Item 402(b)(2) (and renumbering proposed Item 402(b)(2) as (b)(3)) that states, "The discussion should include a specific discussion with respect to the factors and criteria upon which the PEO's reported compensation was based and, to the extent not based upon subjective performance assessments, the factors and criteria upon which the reported compensation of each named executive other than the PEO was based." In addition, the final rules should expressly set forth in the Instructions to Item 402(b) the statement made in the Proposing Release regarding the ability to have a single discussion when materially similar arrangements cover a number of the NEOs.[12]

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senior executive's compensation to the registrant's performance for that particular year, including a description of the specific elements of performance (*e.g.*, earnings, quality rate, market share) relied on in making the award to the particular executive."

[11] 1992 Adopting Release, part II.H. ("A number of commenters also raised concerns about the appropriateness of public assessments of individual officers' performances, particularly in the case of those other than the CEO, and the need for disclosure of proprietary business information in the discussion of the performance of these executive officers.... In response to concerns expressed by commenters with respect to application of the proposed report requirement to the named executive officers subordinate to the CEO, the Commission has revised the requirement to limit the specific discussion to the CEO.").

[12] The Proposing Release states, "The Compensation Discussion and Analysis should be sufficiently precise to identify material differences in compensation policies and decisions for individual named executive officers where appropriate. Where policies or decisions are materially similar, officers could be grouped together. Where, however,

C. The Six Elements

While it is important and helpful for CD&A disclosures to cover the objectives, elements and design of a company's overall compensation program for its NEOs, as called for under proposed Item 402(b)(1), the disclosures that a company provides in response to these items may not vary significantly from year to year, since most companies do not frequently change their overall compensation philosophy and goals, their decision-making process or the basic elements of executive compensation. The fact that the disclosures regarding these topics may not change from year to year does not necessarily mean that the disclosure is boilerplate. However, certain aspects of the regulatory text under proposed Item 402(b)(1) may lead to boilerplate because they appear to call for a normative discussion of topics whether or not those topics were in fact material factors addressed by a compensation committee or in fact are relevant to the registrant's compensation programs. For example:

- The text in proposed Item 402(b)(1)(ii) requiring a discussion of what a company's compensation program is designed not to reward appears to call for a list of everything that a company could have – but did not – design its program to achieve. That type of list could be endless (most companies' compensation programs are designed not to reward activities that alienate customers, drive down the stock price, violate the law, etc.), but does not add any information beyond what a reader learns from the discussion of what the program is designed to reward.[13]

- The text in proposed Item 402(b)(1)(v) requiring a discussion of how the registrant determines the amount for each element of pay will lead to boilerplate disclosures because many elements of compensation that are proposed to be covered by the compensation tables do not reflect current decisions by the compensation committee. For example, the compensation committee has little control over the amount that is realized by an executive when he or she decides to exercise a stock option. Similarly, once a deferred compensation plan and the investment alternatives under it are established, a compensation committee has little or no role in determining the amount of earnings participants accrue on past deferrals. In addition, once a compensation committee has determined to grant restricted stock, the board's decision to declare a dividend payable to all stockholders (which by state law includes holders of restricted stock) is not typically viewed as a compensation decision.

- The text in proposed Item 402(b)(1)(vi) requiring a discussion of how each compensation element affects decisions regarding other elements again requires normative disclosure, because it presupposes that every element of compensation required to be disclosed under

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the policy for an executive officer is materially different, for example in the case of a principal executive officer, his or her compensation would be discussed separately."

[13] For the same reason, we do not believe it would be productive to provide disclosure on what a company's compensation program is designed to discourage.

the Commission's proxy rules is taken into account in setting other elements of compensation. To satisfy this requirement, a company might conclude that in addition to stating, where appropriate, that the size of option grants is taken into account in determining the size of long-term cash incentive opportunity awards, the company would have to disclose that those decisions are not affected by the size of an executive's pension or deferred compensation balance, the value of past restricted stock grants, etc. As with the proposed disclosure on what compensation programs are <u>not</u> intended to reward, the requirement to provide disclosure of how one element of compensation affects other elements would not provide meaningful information to investors in cases when there is no such relationship. Instead, this item should call for a discussion of how the different elements of compensation fit into the company's compensation philosophy.

To address the foregoing points, we recommend that the lead-in language to the six topics in proposed Item 402(b) be revised to require disclosure only to the extent a topic is applicable to a company's compensation arrangements.[14] To focus the scope of the discussion (and because the Summary Compensation Table will cover three years of compensation), the first sentence of proposed Item 402(b)(1) also should be revised to require the report to "Discuss the <u>bases for, principles underlying and factors affecting</u> compensation awarded to, earned by, or paid to the named executive officers <u>for the last fiscal year</u>." To conform with proposed Item 402(b)(2) and the Instructions to proposed Item 402(b), which make it clear that the focus of the CD&A should be material information, the second sentence of proposed Item 402(b)(1) should be revised to read, "The discussion shall explain all <u>material</u> elements of the registrant's compensation of the named executive officers."

D. Examples of Possibly Material Information

Proposed Item 402(b)(2) provides several illustrative examples of the types of material information that it may be appropriate for a registrant to discuss in the CD&A about its compensation objectives and policies. While these examples are quite helpful, we have recommendations for clarifying aspects of several of the specific items that are listed in the Proposals as possibly material information.

- <u>Award Timing.</u> Proposed Item 402(b)(2)(iv) would, for the first time, require companies to disclose how the determination is made as to when equity-based awards are granted. We understand this new disclosure item is intended to address the timing of awards in relation to the registrant's compensation-setting cycle or process, in contrast to the selection of particular dates of grants, because particular grant dates are typically tied to the scheduling of a compensation committee meeting and regardless are within the

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[14] The language could read, "The discussion shall describe the following<u>, to the extent applicable</u>:" The language of proposed Item 402(b)(2) could be conformed to read, "While the material information to be disclosed under Compensation Discussion and Analysis will vary depending upon the facts and circumstances, examples of such information may include, ~~in a given case,~~ among other things, the following<u>, to the extent applicable</u>:"

legitimate business judgment of the compensation committee, and thus would rarely implicate a material policy issue. For example, when option grants are made early in the year, the proposed item would require disclosure of whether the option grants are viewed by the compensation committee primarily as an award for the prior year's performance or as an incentive for future performance. We believe this additional disclosure could be helpful and that the discussion of timing should not be limited to equity award grants, but should encompass other compensation decisions as well, to the extent that any such decisions are material. For example, it may be relevant whether the performance criteria upon which a bonus is based are established early in the year or are determined after the fact. To the extent the Commission intends to address the frequency with which awards are made (for example, quarterly, annually, once every three years), the language should specifically refer to frequency.

- Corporate Performance Measures. Proposed Item 402(b)(2)(v) addresses the specific items of corporate performance that are taken into account in setting compensation policies and making compensation decisions. Although the example uses the word "specific," it appears that the example contemplates a general discussion of the nature of performance criteria or measures (for example, earnings-per-share, total shareholder return), rather than the specific quantitative or qualitative metric that the registrant has used or is planning to employ. This conclusion is supported by Instruction 4 to proposed Item 402(b), which makes it clear that registrants are not required to disclose target levels with respect to specific quantitative or qualitative performance-related factors, or any factors or criteria involving confidential commercial or business information. To reinforce this distinction, we recommend that the Commission revise the item to read, "What corporate performance criteria are taken into account in setting compensation policies and making compensation decisions."

- Structuring Compensation for Individual Performance. Proposed Item 402(b)(2)(vi) addresses the structuring of specific forms of compensation to reflect an NEO's individual performance and/or his or her individual contribution to specific items of the registrant's performance. As discussed above, it is our view that this discussion should not require disclosure of the subjective individual performance assessments of any individual NEO other than the PEO. To reflect this, we recommend that the Commission add an overriding Instruction to Item 402(b) that, similar to Instruction 4 with respect to non-disclosure of target levels for quantitative or qualitative performance-related factors, makes it clear that a registrant is not required to disclose such subjective individual performance assessments for NEOs other than the PEO.

- The Relationship of Compensation to Corporate Performance. Proposed Item 402(b)(2)(vii) refers to "[h]ow specific forms of compensation are structured to reflect these items of the registrant's performance." This item also appears to be addressed to the design, and not the actual operation, of performance-based compensation programs. We believe that it may also be material to discuss whether performance measures were refined, modified, amended or waived when determining actual payouts. As discussed further below, this discussion should address any modifications to stock-based plans or awards as well as to cash-based incentive plans.

- Prior Compensation Decisions. Proposed Item 402(b)(2)(ix) addresses normative disclosure of "how" compensation or amounts realizable from prior compensation are considered in setting other elements of compensation. We are concerned that this example may be interpreted as a requirement to justify a current pay decision in light of an executive's accumulated wealth from his or her employment. As presently drafted, the proposed rule can be read to imply that the compensation committee should have a specific reason for compensating an executive once he or she has accumulated a certain level of financial success separate and apart from the registrant's desire to retain and motivate a highly-valued employee. Because we believe that the Commission's disclosure rules should not attempt to mandate or influence the manner in which compensation committees determine how to set executive compensation, we recommend that this item be revised to read, "Whether compensation or amounts realizable from prior compensation ... are considered in setting other amounts of compensation, and if so, how...."

- Accounting and Tax Implications. Proposed Item 402(b)(2)(x) addresses the impact of accounting and tax treatment of particular forms of compensation. We recommend that this item be clarified to make it clear that it refers to the accounting and tax implications to the registrant as a result of the structure and design of a particular compensation form, and not necessarily the consequences to individual recipients.

E. Interaction with Proposed Item 407 Compensation Committee Disclosures

Among other things, subsection (e)(3) of proposed Item 407 (which addresses the disclosure of a registrant's corporate governance structure) would require a narrative description of the registrant's processes and procedures for considering and determining executive and director compensation, including certain information about the scope of authority of the compensation committee (and the extent to which the committee may delegate any of its authority), the role of executive officers in determining or recommending an amount or form of executive and director compensation and the role of any compensation consultant utilized in the compensation-setting process.

In recent years, many registrants have begun to discuss their processes and procedures for determining executive compensation in their BCCRs, and the discussion called for under proposed Item 407(e)(3) is closely integrated with the topics to be covered by proposed Item 402(b). We believe that combining these discussions has merit, as it provides investors with a description in a single location of both the compensation committee's compensation decisions and the process that it utilizes in making those decisions, including the committee's duties and responsibilities and the role of compensation consultants and other advisors. Moreover, investors have become accustomed to locating this information in the BCCR. Thus, we recommend that, in the final rule, the Commission permit registrants to present this information as part of the CD&A. Permitting registrants to address this item in the CD&A, would both assist investors in accessing this information and avoid needless duplication simply to satisfy the technical requirements of the rules. To the extent that including this information in the CD&A would subject it to the PEO and PFO certifications, the Commission should expressly exclude this information from the certification requirement, so that the decision as to where to disclose this information is not affected by considerations arising from the certification process.

In addition, in the context of proposed Item 407(e) and – if the Commission determines to make the CD&A "filed" and thereby incorporated by reference into a registrant's Securities Act filings – in the context of the CD&A, we believe that it is important to confirm that naming a compensation consultant and discussing the consultant's role in the compensation committee's deliberations on executive compensation do not "expertize" the consultant for purposes of Securities Act liability.[15] We understand that if a company states that it has used a consultant to help it determine the factors to be applied in calculating the fair value of equity compensation arrangements for purposes of applying FAS 123R, the Commission's accounting staff will request the registrant to identify the consultant and will require the consultant to consent to being named as an expert. We believe the context of those FAS 123R valuations, which are used for preparing a registrant's financial statements, are different from registrants' references to the compensation committee's use of data, advice and recommendations provided by compensation consultants in the compensation-setting process. Because compensation committees have the responsibility for setting compensation under both state law and the listing standards of the NYSE and NASDAQ, we do not believe that references to compensation consultants should be viewed as purporting to base compensation on the authority of an expert or purporting to provide reports or valuations of an expert. In order to avoid chilling the discussion of a consultant's involvement in setting compensation, we recommend that the Commission adopt a rule similar to existing Item 401(h)(4) of Regulation S-K (regarding audit committee financial experts) stating than any compensation consultant named in response to proposed Item 407(e) and – if the Commission determines to make the CD&A "filed" – any compensation consultant named in the CD&A will not thereby be deemed an expert for any purpose, including for purposes of section 11 of the Securities Act.

F. Order of Presentation

The Proposals suggest that the CD&A is to precede the other disclosures that are required under proposed Item 402.[16] If the Commission intends to require a specific order of presentation, it

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[15] The Staff has informally stated following issuance of the Proposals that such discussions do not "expertize" the compensation consultant.

[16] *See, e.g.,* Proposing Release at part II.A.1, stating "The Compensation Discussion and Analysis is intended to put into perspective for investors the numbers and narrative that follow it."

should expressly state that in Item 402. However, we do not believe that the Commission should mandate a specific ordering of disclosures within the proxy statement. To date, no Commission rule requires the items presented under Schedule 14A to appear in a specified order, and registrants have been able to organize their proxy statements in a manner that they determine most effectively communicates the provided information. We believe that, as the Commission has not demonstrated any abuse of this discretion, this flexibility should be maintained.

G. Proposed Elimination of the Performance Graph

We agree with the proposed elimination of the Performance Graph.[17] Most companies present peer group stock price performance on a "published industry or line-of-business" basis within the meaning of Item 402(l), due to the difficulty and expense of developing stock price performance graphs for customized peer groups and the strict rules governing changes in that peer group. As a result, the graphs presented by most companies do not present the stock price performance of peer companies that are used by compensation committees in setting executive compensation. Moreover, the existing graph presentation reflects a disclosure bias in favor of evaluating performance on the basis of stock price, whereas compensation decisions are frequently based on other criteria. As the Commission noted in the Proposing Release, most investors have ready access today to stock performance information about companies, industries and stock indexes through the Internet or similar sources.

Nonetheless, some companies may wish to continue to provide a Performance Graph as part of their executive compensation disclosure, either to support a discussion in the CD&A, when applicable, of stock price performance (or other performance measures, as is suggested by Instruction 4 to existing Item 402(l)) and its relationship to particular elements of the registrant's executive compensation program, or as an accommodation to the registrant's shareholders. Accordingly, we believe that the Commission should provide that, if a company voluntarily determines to include a Performance Graph, it will be considered "furnished" and not considered to be "soliciting material" or to be "filed" with the Commission or subject to Regulation 14A or 14C, except to the extent that the registrant specifically requests that such information be treated as soliciting material or specifically incorporates it by reference into a filing under the Securities Act or Exchange Act.

II. The Summary Compensation Table and Related Disclosure

A. Basis of Presentation

We support the Commission's decision to revisit the items that are to be included in or excluded from the Summary Compensation Table ("SCT"). We agree that the proposed changes to the SCT are generally appropriate and streamline the disclosure. In particular, we agree that doing away with the distinction between Other Annual Compensation and All Other Compensation in

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[17] Current Item 402(l).

the SCT facilitates understanding of a particular company's compensation structure. However, we believe that – particularly in light of the proposed "Total" column – it is important to have an articulated and consistent basis for determining the items that appear in the SCT, in order to avoid disparities between different types of compensation arrangements or different registrants. The basis applied under the Proposals for determining what appears in the SCT is neither articulated nor readily apparent. Some of the items represent amounts awarded and earned during the year, other items reflect amounts awarded during the year that may or may not actually be realized by the executive, and still other items reflect amounts earned in one year as a result of compensation decisions made in past years. This results in anomalies in the proposed disclosures. For example:

- Most of the columns report amounts earned, but the Stock Awards and Option Awards columns include opportunities for future earnings that were awarded during the year.

- An incentive program that pays $1 million in cash upon achievement of a performance goal is reported in the SCT when earned, but if the $1 million award is payable in either cash or stock (at the company's election) it may not be reportable in the SCT upon either grant or payout.

- The increase in value in unvested restricted stock awards is not reported in the SCT, but if a vested award is deferred, any increase or decrease in the stock's value is reported in the All Other Compensation column.

1. Basis of Presentation for Equity Plan Awards

We believe that the most appropriate basis of presentation for the SCT is to report the fair value of equity awards over the service or vesting period required under the award, in a manner consistent with the approach taken in FAS 123R, instead of reporting the fair value of all stock options or restricted stock[18] granted during a year. This proposed approach is consistent with one manner in which compensation disclosure is described in the Proposing Release, that is, "presents compensation paid currently or deferred." Reporting the fair value over the service period has a number of advantages:

- It more fully embraces the standards developed under FAS 123R. Equity awards are generally structured as long-term compensation, rewarding the recipient for service over a period of years.[19] The Financial Accounting Standards Board deliberated for ten years

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[18] Unless indicated otherwise, references in this comment letter to options include stock appreciation rights (SARs) and references to restricted stock include restricted stock units (RSUs).

[19] The Proposing Release states, "We believe that this approach [reporting full fair value in the year of award] is more consistent with the purpose of executive compensation disclosure." However, the "purpose" is not articulated. While we concur that some aspects of FAS 123R may not be appropriate in this context, such as liability accounting,

regarding the appropriate methodology for reporting stock-based compensation expense and determined to record the value over the term of service.

- It acknowledges the fact that equity awards are typically subject to vesting conditions over a period of years. When it is not certain that the executive will ever receive the entire amount awarded, it is potentially misleading to require that the full fair value of an award be included in the SCT and counted as part of the reported "Total" in the year awarded.

- It will result in greater comparability both within companies and among companies. The service period for vesting of equity awards varies between companies, and even within companies it is not unusual for some awards to be subject to a longer vesting requirement than at other companies. Likewise, some companies grant large awards every third or fourth year while other companies make smaller awards every year. Presenting award fair values over the service or vesting period will result in greater comparability in disclosures so as to accommodate each of these practices. The presentation also would be more consistent with the presentation of non-stock incentive plan awards, which are proposed to be reported as earned.

- Investors would still have information on the size of equity awards in a year, since that information would be reported in the grant tables that accompany the SCT. As we recommend below, that table could be expanded to report grant date fair values.

If the presentation of equity awards is not changed, the SCT should be reformatted and presented with two "Total" columns: one of which would report "Total Paid Currently or Deferred" and the other of which would report "Total Equity Opportunities Awarded." This approach has the benefit of highlighting to investors that the SCT presents compensation on two different bases, while maintaining the advantages of a single SCT.[20] The proposed supplementary equity award tables provide information on the value of such awards in subsequent years.

2. Inclusion of Post-Employment Arrangements

We recognize and support the Commission's goal in proposing expanded disclosure of non-qualified defined contribution plan and pension plan benefits. However, for the reasons discussed below we do not believe that those amounts should be included in the SCT and similarly do not believe that those amounts should be counted in the "Total" column. These elements of compensation reflect wealth accumulation and compensation that is derivative of

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we believe that allocating the expense over the service or vesting period more accurately reflects the value to a company when its compensation program provides for options with multi-year vesting.

[20] The Commission has requested comments on the possibility of requiring two separate SCTs, one that would focus on earnings during a year and the other focusing on awards made during the year. We believe that it is not necessary to include a second SCT for awards made during a year and that providing instead two "Total" columns is a more readable presentation.

other elements of compensation that will already have been reported in the SCT. Thus, as with the proposed disclosure for equity awards, these elements of compensation should be addressed only in the post-employment compensation tables, which we discuss in Part V of this letter.

a) Earnings on Deferred Compensation

The existing rules should be retained under which the SCT includes only (i) current year employer contributions or allocations to an NEO's account and (ii) preferential earnings and rates of return on defined contribution and other deferred compensation plan account balances. In this regard, the Commission should codify the existing Staff interpretation that earnings and changes in the value of investment funds should be treated as "preferential" or "above market" unless the investment vehicles or returns are available on a non-discriminatory basis to salaried employees of the company under a tax-qualified defined contribution plan. We believe that preferential earnings should be viewed and reported differently than rates of return that are available to employees generally. The proposed approach, where Instruction 5 to proposed Item 402(c)(2)(ix) would permit – but not require – identification of preferential earnings, would result in less meaningful disclosures.

We believe that the Nonqualified Defined Contribution and Other Deferred Compensation Plans table under proposed Item 402(j) is the more appropriate location for disclosure of information other than current year employer contributions or allocations to an NEO's account and preferential earnings and rates of return. We strongly oppose the proposed disclosure in the SCT of non-preferential "earnings" on defined contribution and deferred compensation plan accounts for the following reasons:

- Amounts accrued with respect to deferred compensation are largely a function of three factors: the total amount that has been deferred by an executive over his or her career with a company, the investment returns or vehicles selected by the executive among those offered by a company under the plan and the length of time that amounts have been allocated in a plan. As a result, the amounts reported would be widely divergent from year to year and as between executives at the same company as a result of factors that do not reflect current compensation decisions by the company.

- Just as with previously granted equity awards and incentive plan awards, accruals under these plans represent amounts that have not yet been realized and that an NEO might not ever realize, depending on the subsequent performance of the investment measures available under the plan.[21] As with the value of unvested restricted stock awards and changes in the value of vested and unvested stock options, the deferred compensation account balances typically fluctuate from year to year and in many cases may decline in a

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[21] *See* the Commission's discussion of outstanding awards that have been granted but the ultimate outcome of which has not yet been realized, at part II.B.4.a. of the Proposing Release.

year.[22] As with stock options and restricted stock, the amounts deferred will be reported in the SCT in the year in which awarded (that is, the amounts earned by executives will be reported in the SCT regardless of whether deferred, and the company's matching contribution will be reported in the year made). Thus, unrealized accruals on these deferred amounts should not be treated differently from other elements of compensation that represent changes in the value of previously awarded compensation that has already been reported in the SCT.[23] Subsequent changes in the value of those amounts should not also be required to be reported in the SCT.

- The anomalies from the proposed disclosure are particularly acute for restricted stock that is deferred and for companies that allow executives to receive options in lieu of cash bonuses. Under the proposed rules, changes in the value of the unvested restricted stock would not be reported in the summary compensation table, but if the restricted stock vests and has been deferred under a company plan, changes in its value would appear in the SCT.[24]

Because balances in deferred compensation plans can vary widely, do not reflect current compensation actions and can also be subject to negative accruals, including these amounts in the SCT and the "Total" column of the table will distort the picture presented by the SCT.

b) Increase in Pension Value

We believe that all disclosures regarding pension plan benefits should be reported in the separate pension plan table, as it is proposed to be significantly enhanced, and we strongly oppose the proposal to include the actuarial value of changes in pension plan benefits in the SCT. Disclosure of pension plan accruals in the SCT is inappropriate because the information is not reflective of current compensation decisions, would result in widely different numbers based on factors such as age, tenure with a company and marital status, and would involve hypothetical valuations that will vary from company to company based on a range of non-standardized assumptions. The amount accrued during a year depends on a variety of factors, including: the

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[22] If the Commission does require disclosure of changes in the value of deferred compensation account balances, the Commission should permit companies to disclose both "earnings" and "losses" (negative amounts due to the decline in the value of investment vehicles).

[23] Although the account balances represent funding obligations of a company, the same is true with respect to equity awards that are settled in whole or in part in cash. As recognized under FAS 123R, equity-based arrangements represent an expense to the company to the same degree as other forms of compensation. Similarly, many companies "fund" their equity arrangements by repurchasing shares on the open market.

[24] It is unclear under the proposed rules whether merely making a deferral election at the time restricted stock is granted might also result in subsequent changes in value to be reported in the SCT, whereas such changes are not reported in the SCT if the same award is not subject to a deferral election.

formula applied to calculate benefits as of a certain age,[25] the amount of time until the anticipated retirement date or eligibility to receive the benefit, the assumptions applied for discounting the value of the benefit, the forms of benefit available under the plan and the marital status of the executive and the age of the executive's spouse. The underlying formula on which the accrual is determined results in a pension benefit that has generally been accumulated by the executive over a long period of time and has little connection with the executive's current year earnings. Thus, the benefit for a newly hired youthful senior executive officer may be significantly lower than the benefit of a lower ranking, lower paid executive who is older and/or has been with the company longer. The value of an executive's benefit may increase or may decline significantly in a single year if the executive marries or if the executive's spouse dies during the year. In addition, unlike other disclosures in the SCT, the amounts reported might represent a benefit that is not currently available to (or that may never be received by) an executive officer and that have no relationship to the company's cost of providing the benefit.

The Proposing Release does not address or provide guidance as to how the actuarial increase in pension value would be calculated. Unlike valuation of stock options under FAS 123R, there is no standardized or accepted measure for calculating the amount proposed to be disclosed. Focusing on the information necessary to present the proposed actuarial value demonstrates the number of issues that would need to be addressed. A threshold issue is whether the amount to be reported is the change in the lump sum present value of the pension benefit or the present value of the change in the dollar value of the executive's annual benefit. If the second of these alternatives is to be used for this purpose, a further decision is needed as to whether the benefit used to determine the calculation should be normalized to a standard form of benefit such as a single life annuity commencing at age 65.[26] Under either of the foregoing approaches, the rule would need to specify the actuarial assumptions (or the basis for determining actuarial assumptions) that companies would need to apply (*i.e.*, interest and discount rate and mortality assumptions) in making the calculation. Specifying a standardized set of assumptions would result in comparability among companies, but would produce a number that is even further removed from what an executive might actually receive. Specifying a basis for selecting assumptions, such as those used for accounting purposes under FAS 87, raises issues of whether assumptions applied to a large group of individuals are appropriately used for attributing a benefit to any one particular executive. Finally, we have other definitional and reporting concerns with the proposed disclosure that are addressed in Part V of this letter. For example, the value of the benefit will be distorted if a company is required to report a benefit attributable to each plan if the company is not also permitted to take into account offsets among plans that in reality will reduce or eliminate the benefit that an executive will receive in the aggregate.

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[25] Plans often apply one formula for participants below a certain age and provide a step-up formula once a participant obtains a certain age.

[26] As discussed further in Part V of this letter, for most qualified pension plans, participants do not elect the form of benefit until they are about to retire.

Thus, although we support improved disclosure of pension plan benefits under the Retirement Plan Potential Annual Payments and Benefits table, we do not believe that an abstract value intended to represent an annual benefit accrual should be quantified in the SCT.

B. Treatment of Incentive Plan Awards

The proposed treatment of incentive plan awards in the SCT and under the other compensation tables is unnecessarily confusing and may not adequately accommodate the variety of such plans. The proposed disclosures are confusing for three reasons:

- The Proposals use two different terms "incentive plan awards" and "performance-based award," and yet the term "performance-based award" is not defined in the proposed regulatory text[27] and the distinction between incentive awards and performance-based awards is not clear.

- In some cases awards are characterized by whether they are denominated in shares and in some cases they are characterized by whether they are payable in shares (even if the award amount is denominated in dollars).

- Performance-based stock awards are in some cases reported in the same column or table with other stock awards and in some cases are reported in the same column or table as non-stock incentive or performance awards.

Among the anomalies this produces are the following:

- A performance-based/incentive plan award that is denominated in dollars but settled in stock is not reported in either the Stock Awards column or the Non-Stock Incentive Plan Compensation column of the SCT.[28]

- A fixed dollar award that is earned if a company's stock price hits a certain target is not reported in either the Stock Awards column or the Non-Stock Incentive Plan Compensation column of the SCT.[29]

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[27] The term "performance-based award" is defined in the text of the Proposing Release at note 125 and in note 87 of the Proposing Release, but is not defined under the proposed Grants of Performance-Based Awards table. The concept of "performance-based" awards is referenced in the proposed regulatory text only in Instruction 1 to proposed Item 402(e) (the Grants of All Other Equity Awards table) and the meaning of "performance-based condition" is defined in the proposed narrative disclosure provisions of Item 402(f)(1)(iii). Proposed Item 402(d)(2)(ii) also refers to "stock-based incentive plans," a term that is not directly defined in the Proposals.

[28] This is because an award is a "non-stock incentive plan" only if "the award does not permit settlement by issuance of registrant equity securities."

[29] This is because an award is a "non-stock incentive plan" only if "the relevant performance measure is not based on the price of the registrant's equity securities." The reference to "the relevant" performance measure is

- Time-based and performance-based restricted stock awards would be treated differently in the supplementary grant tables to the SCT, but for all other purposes would be treated the same: both would be reported in the same column in the SCT in the year of grant[30] and both would be reported in the Outstanding Equity Awards at Fiscal Year-End table and the Option Exercises and Stock Vested table.

- The treatment of a restricted stock award in the supplementary grant tables to the SCT would differ solely as a result of attaching a minimal performance condition to the grant, as is often done for restricted stock grants in order to qualify those grants for deductibility under Section 162(m) of the Internal Revenue Code (the "Code").[31]

- Grants of options that are exercisable only if the stock price rises by five percent would appear in the Grants of Performance-Based Awards table but grants of options that have value only if the stock price rises are reported in a different table.

- The extent of information provided on an option that is exercisable only if a performance condition is satisfied is less than that presented for traditional stock options;[32] and

- Some awards in the Grants of Performance-Based Awards table would appear in the SCT in the year of grant and others would not.

This aspect of the Proposals results in inconsistent presentations based upon inconsequential distinctions and is unnecessarily confusing. Instead, we believe that all awards that are

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ambiguous. If a stock-settled SAR vests upon achieving a certain revenue goal, it is unclear whether "the relevant performance goal" is the company's stock price, which determines the value of the award, or revenues, which determines vesting of the award. If the latter, then this type of award would appear in the SCT at the date of grant under the Option Awards column and would appear again in the SCT at the date of payout under the Non-Stock Incentive Plan Compensation column.

[30] This treatment is discussed in the Proposing Release, in the text at note 77, but is not set forth in the proposed regulatory text.

[31] Code Section 162(m) requires that performance conditions be "substantially uncertain at the time the compensation committee actually establishes the goal." However, the compensation need not be subject to a substantial risk of forfeiture. The regulations under Code Section 162(m) provide, "A performance goal need not, however, be based upon an increase or positive result under a business criterion and could include, for example, maintaining the status quo or limiting economic losses (measured, in each case, by reference to a specific business criterion)." 1.162-27(e)(2)(i). As an example, the regulations posit a situation where a bonus is based on a percentage of a company's total profits for the fiscal year. The regulations state this type of performance goal can satisfy Code Section 162(m) "even if the company has a history of profitability" since "it is substantially uncertain whether a company will have profits for a specified future period." 1.162-27(e)(2)(vii), Example 3.

[32] Only the number of shares and grant date would be reported in the Grants of Performance-Based Awards table for the option that vests based on a performance condition being satisfied, whereas that information plus the option's exercise price and expiration date would be reported in the Grants of All Other Equity Awards table for the other option.

denominated in terms of a company's equity should be reported in a consistent manner throughout the compensation tables, regardless of whether such awards have performance conditions, and that all incentive plan awards that are denominated in dollars should be treated the same.

Under our recommended approach, equity awards that have a performance condition would be reported in the same supplementary grant table as awards of options, SARs, restricted stock and RSUs. This table would apply to all awards denominated in terms of shares of stock[33] and would be entitled "Grants of Equity Awards." Under this approach, the "Grants of Performance-Based Awards" table would be renamed "Grants of Non-Stock Incentive Awards."[34] Our recommended approach has the additional benefit of simplifying the proposed Grants of Performance-Based Awards table. As proposed, this table would have up to 10 columns of information and even then would provide less information on stock-based awards than would apply for other options and restricted stock under the Grants of Equity Awards table. The new table would be organized as follows:

GRANTS OF NON-STOCK INCENTIVE AWARDS

					Estimated Future Payouts		
Name	Number and Type of Award	Dollar Amount of Consideration Paid for Award	Period Until Vesting or Payout	Expiration Date	Threshold	Target	Maximum
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)

Under this approach, the definition of "non-stock incentive plan" would be revised to cover "any plan or portion of a plan intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance, stock price or any other performance measure, where the amount payable is not denominated in shares of the registrant's equity securities (regardless of whether amounts earned under the plan may be paid or settled by issuance of registrant equity securities)."[35] As discussed below in Part II.C.2 of this letter, we also believe that this table should apply only to "long-term" incentive plan arrangements, and that annual incentive arrangements should continue to be reportable as bonuses.

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[33] An award that is denominated in dollars, but which could be paid in shares of stock (regardless of whether at the company's or executive's election), would not be reported as an equity award.

[34] This approach has the benefit of tying this table directly into the similarly captioned pay-out column in the SCT.

[35] This proposed definition includes elements of the definition of "incentive plan" because there would be no need for the definition to also accommodate or encompass stock-based awards.

C. Specific Components of the Summary Compensation Table

We have the following additional comments regarding the proposed SCT disclosures.

1. Total Compensation Column

We are not opposed to a "Total" column (or columns) in the SCT, although our members have differing views as to what should be included in that column. The proposed SCT accurately refers to this column as "Total," and we believe it is important that the amounts reported in this column not be referred to as "total compensation." This is because there is widespread debate as to how to measure "total compensation" [36] and views on how to measure "total compensation" are likely to change over time.[37] The Commission's goal should be to ensure that there is appropriate disclosure of the elements of executive compensation and not to take a position on how to measure "total compensation."

2. Salary and Bonus Columns

The proposal to eliminate the "long-term" element from the definition applicable to incentive plans likely will create confusion and therefore should be reconsidered. Specifically, if the Commission does eliminate the "long-term" element from the definition of "incentive plan," the Commission needs to clarify when amounts would be reported as bonuses and when they would be reported as non-stock incentive plan payouts that are earned over only one year. The proposed definition for incentive plans encompasses any plan (which we assume need not be a written plan) providing compensation intended to serve as an incentive for performance. This definition does not require that the performance measure be objectively determinable or pre-established. Thus, a bonus paid based on subjective goals set for the current year appears to qualify as an incentive plan payment. As a result, many arrangements that are commonly referred to as annual bonuses would instead be reported as incentive plan payments. If, however, the Commission intends to change the scope of the Bonus column to encompass only arrangements that are not performance-based (*e.g.*, sign-on bonuses, retention or service payments) or intends there to be a distinction between the Bonus column and the Non-Stock Incentive Plan Compensation column that is based on whether performance criteria are established at the beginning of the performance period, that distinction needs to be stated in the

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[36] For example, different periodicals that report on executive compensation have measured "total compensation" in different manners. In its annual review of executive compensation, the New York Times measures total compensation as the sum of base salary, bonus, restricted stock, long-term incentives, the reported value of "other compensation" and an option grant value, whereas Forbes measures total compensation as salary, bonuses, other compensation (including vested restricted stock grants) and stock gains (the value realized by exercised stock options). In addition, some commenters have noted that the proposed "Total" column does not present "total compensation."

[37] For example, as companies move increasingly to restricted stock and RSU grants instead of options, measures of total compensation may increasingly focus on the value of equity compensation that vested in a year as opposed to grant date values.

rules. Nevertheless, we believe the distinction under the current rules between the Bonus column and the Long-Term Incentive Plan Payout column works generally well[38] and comports well with the way that compensation committees and investors analyze compensation, and therefore should be retained.

3. Stock Awards and Option Awards Columns

In addition to the comments set forth above regarding the basis of presentation for stock and option awards in the SCT, the Proposals raise a number of significant issues.

We strongly oppose the proposal to require full fair value reporting of options that have been materially modified. We believe that the proposed narrative disclosure accompanying the Equity Grant table is the appropriate place to address this topic, and we would also expect these actions to be discussed in the CD&A to the extent they reflect material policy or compensation decisions. Although repricings themselves are now rare and typically are subject to stockholder approval, modifications that may be deemed to be material[39] occur more frequently. For example, it is not uncommon to extend the post-employment exercise period of outstanding options. In these situations, the full value of the award as modified is not representative of either the cost to the registrant or its shareholders or of the benefit to the executive; the incremental value resulting from the modification, as is contemplated by FAS 123R, is more representative of the value of the benefit provided to the executive. Full fair value reporting of modifications results in double counting of the same awards and thus conflicts with the principle reflected in proposed Item 402(a)(2), which states "No amount reported as compensation for one fiscal year need be reported in the same manner as compensation for a subsequent fiscal year." The proposal also results in disparate disclosure between equity arrangements and cash-based arrangements, since a modification or waiver of conditions under non-stock incentive plans is not proposed to result in similar disclosure.

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[38] We recognize that maintaining a distinction between annual bonuses and long-term incentive arrangements raises an issue when a compensation arrangement has both annual and long-term elements and when payments are based solely on continued employment over a multi-year period (*e.g.*, a retention bonus). The first situation requires the payouts to be split between two columns, *see* Executive Compensation Disclosure, Exchange Act Rel. No. 32723 (Aug. 6, 1993), providing interpretive guidance at part IV.A, which companies generally have managed by providing footnote disclosures to adequately describe the nature and interaction of such arrangements. The Commission could clarify in the adopting release the reporting principle applicable to the second situation; that is, whether such amounts are reported in the Bonus column or in the All Other Compensation column.

[39] If the Commission were to retain the proposed presentation, it or the Staff would need to give greater guidance as to what is treated as a material modification of a grant. While the issue exists under the accounting rules, in that context it often is moot when an amendment either reduces or does not increase the incremental value of an award. For example, an amendment that allows or requires a participant to pay an option exercise price through a net share settlement (in effect, converting an option to an SAR) and an amendment that disqualifies an option's status as an Incentive Stock Option under tax rules each could be viewed as a material amendment, and yet neither increases the fair value of the option.

We believe that it is preferable to disclose earnings[40] on outstanding equity awards in the All Other Compensation column of the SCT, instead of in the same columns in which grants are reported.[41] Including dividends in the equity awards columns obfuscates the content of the columns by mixing grant date fair values of new awards with dividends on past awards. As a result, two executives who receive identical option grants could have significantly different amounts reported in the same equity awards columns.[42] Moreover, because FAS 123R factors the value of a future dividend stream into the determination of an equity award's fair value, reporting those earnings in the same column in which the awards themselves are reported results in double-counting.

The Proposals would require companies to report the fair value of awards based upon the same expected term assumption used for computing the grant date fair value for financial statement purposes under FAS 123R, which can result in anomalies that should be addressed in the final rules. As stated in note 90 to the Proposing Release, FAS 123R requires a company to aggregate individuals receiving awards into relatively homogenous groups for purposes of determining expected term and other option valuation characteristics. Executive officers often receive equity grants with vesting terms that are longer than those applicable to many of a company's other equity awards, and yet it is not unusual for these awards to be aggregated with awards carrying shorter expected terms for financial reporting purposes. In these cases, the effectiveness of a fair value presentation could be undermined since, for example, an option with a six-year vesting condition might be valued on the basis of a five-year term. Accordingly, we believe the final rules should allow companies to apply a different term assumption for proxy statement

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[40] We understand the reference to "earnings" to refer to dividends and dividend equivalents and not to the appreciation in the value of shares underlying options or restricted stock. However, the Proposals use the term "earnings" in inconsistent ways. For example, it is unclear whether the reference to "earnings" on deferred compensation in proposed Item 402(c)(2)(ix)(B) similarly refers only to dividends and interest accrued in a deferred compensation account or also includes appreciation to account balances based upon the value of underlying investments, and the term "earnings" appears to have yet a third usage and meaning in proposed Item 402(c)(2)(viii)'s reference to "earnings" under non-stock incentive plans. In each instance, the final rules and adopting release should more specifically identify what is intended to be encompassed by the disclosure requirements. For example, in the context of earnings on equity awards, the language could be revised to refer to disclosure of "preferential and non-preferential dividends, dividend equivalents and similar earnings."

[41] One exception is when dividends on prior awards are deemed to be reinvested in additional awards. The Commission should clarify whether such dividend reinvestments are to be reported as new grants or reported in the same manner as other dividend accruals and dividend equivalent rights. Separately, we would expect that companies should disclose whether dividends are paid in the year accrued or whether they are subject to deferral and/or risk of forfeiture.

[42] If, however, dividends or dividend equivalents are "reinvested" so as to result in new equity awards, then those awards should be reported in the appropriate awards column.

disclosure purposes than for financial statement reporting purposes accompanied by disclosure of the term assumption.[43]

If the final rules do not allow companies to apply a different expected term assumption than is used for financial reporting purposes, the Commission should provide a safe harbor protection from potential liability for what may be viewed as the use of inappropriate assumptions for a particular grant, or should allow companies to disclaim the fair value disclosed for affected equity awards (in a manner similar to disclaimers that companies provide with five and ten percent annual appreciation disclosures under the current rules). Regardless of the standard adopted by the Commission for determining the fair value of equity awards reported in the SCT, because the SCT equity awards columns may include numerous grants for each NEO, we believe that the assumptions should be stated in footnote text tied to specific grants that accompanies the supplementary grant table(s), instead of being included in footnotes to the SCT.[44]

4. Non-Stock Incentive Plan Compensation Column

For the reasons discussed above, we believe this column should address only long-term, non-equity incentive arrangements. In addition, the phrase "earnings for services performed during the fiscal year" in proposed Item 402(c)(2)(viii) appears inapposite in the context of performance-based awards and could be read to refer to annual accruals under a non-stock incentive plan, regardless of whether amounts are paid or payable under the plan. To address this, we recommend that the language in proposed Item 402(c)(2)(viii) be revised to read, "The dollar value of all amounts earned for a performance period that ended with or during the fiscal year pursuant to awards under non-stock incentive plans as defined in paragraph (a)(6)(iii) of this Item."

5. All Other Compensation Column

As noted above, we support eliminating the current distinction between "Other Annual Compensation" and "All Other Compensation" and otherwise expanding the scope of disclosure required in the SCT. Consistent with current requirements, however, the regulatory text in proposed Item 402(c)(2)(ix) should continue to state that the last column in the SCT must disclose all other compensation for the fiscal year "except as otherwise specifically provided under this Item." This is because the proposed rules state that certain elements of compensation are to be reported in other tables, and the additional language above conforms the item with

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[43] We advocate below that the equity grant tables show grant date fair values to assist investors in reconciling individual grants to the aggregate fair values reported in the SCT. If this approach is adopted, the footnotes disclosing the term assumptions would more appropriately appear with the table reporting the individual grants than with the SCT.

[44] Specifically, Instruction 1 to proposed Item 402(c)(2)(vi) and (vii) should be deleted and the footnote text called for by that Instruction should instead appear as footnote or narrative text accompanying the supplementary grant table in which individual equity grants are reported.

proposed Instruction 1 to the item, which states that the column should not include amounts that are required to be reported elsewhere pursuant to Item 402.[45] In addition, the proposed rules

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[45] We believe that it is important to recognize and acknowledge that the existing executive compensation disclosure rules also specifically authorize omitting information on certain forms of compensation. Item 402(a)(2) of Regulation S-K, which is frequently cited as a source of a general disclosure mandate, reads:

> This item requires clear, concise and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers designated under paragraph (a)(3) of this item, and directors covered by paragraph (g) of this item by any person for all services rendered in all capacities to the registrant and its subsidiaries, <u>unless otherwise specified in this item</u>. (emphasis supplied)

Among other rules authorizing non-disclosure are Item 402(a)(7)(ii) (**"**Registrants may omit information regarding group life, health, hospitalization, medical reimbursement or relocation plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant and that are available generally to all salaried employees."**)**, and Item 402(b)(2)(iii)(C) (requiring disclosure of only above-market or preferential earnings on certain forms of compensation) which the Staff has interpreted as not requiring disclosure of certain elements of compensation that the Proposals would now, for the first time, require to be disclosed. *See* Staff Telephone Interpretation J15 ("There is no required reporting of dividends or dividend equivalents paid or credited on restricted stock or restricted stock units unless such payments are preferential.") and J.2S (March 1999 supplement) ("A registrant need not report earnings on salary and bonus deferred pursuant to non-tax qualified arrangements as "above-market or preferential earnings" …where the return on such earnings is calculated in the same manner and at the same rate as earnings on externally managed investments to employees participating in a tax-qualified plan providing for broad-based employee participation.")

We recognize that these "line item" disclosure requirements are supplemented by Rules 12b-20 and 14a-9, requiring disclosure of any additional information necessary to prevent the disclosures that are made from being misleading. Nevertheless, in many court cases, where plaintiffs have asserted that additional or alternative disclosures should have been made, the courts have rejected the claims based on the fact that the disclosures sought by the plaintiffs were not required under the Commission's rules. (*See, e.g.*, Seinfeld v. Gray, 404 F.3d 645 (2d Cir. 2005) (affirming dismissal of shareholder's allegation that a company's proxy statement was misleading for failure to disclose certain information about a stock option plan, holding that SEC rules do not require disclosure of number of options that might be granted under stock option plan, and that proxy statement is not materially misleading because of that omission); Resnik v. Schwartz, 303 F.3d 147, 151-52, 154 (2d Cir. 2002) (affirming dismissal granted to a company against shareholder's claim that a proxy statement should have disclosed a Black-Scholes estimate of options, noting that "the plain language of Regulation S-K fails to support [that] contention." The court further noted that "[d]isclosure of an item of information is not required ... simply because it may be relevant or of interest to a reasonable investor. For an omission to be actionable, the securities laws must impose a duty to disclose the omitted information."); Vides v. Amelio, 265 F. Supp. 2d 273, 281 (S.D.N.Y. 2003) (dismissing shareholder's claim that a company failed to disclose that directors' compensation had increased at a greater rate than the company's earnings and stock price, holding that the regulations do not require disclosure of historical director compensation figures or comparisons of director compensation with earnings, and that the information is not required to make other proxy disclosures not materially false or misleading).

When registrants have in good faith relied on the Commission's rules in making their disclosures and courts have upheld them in that reliance, and at a time when the Commission itself is engaged in rulemaking to determine whether to "fill the gaps" in disclosure under its existing rules, we believe that it is unfortunate that the Proposing Release in certain places may be read to suggest that the existing disclosure requirements are broader than the language of the rules supports. As discussed in this comment letter, we support the Commission's proposals to expand the disclosure requirements. In addition, consistent with speeches of the Commissioners and the Staff, our continue to exclude certain elements of compensation, such as discounts on stock available to all shareholders or employees and the value of group life, health, hospitalization or medical reimbursement plans that do not discriminate in favor of executive officers or directors of the company and that are available generally to all salaried employees.

We question proposed Item 402(c)(ix)(D), providing for disclosure of the cost computed in accordance with FAS 123R of any equity security sold at a discount under a program that is not broadly available. Any such stock purchase arrangement that has option-like features or that involves awards of restricted stock or similar instruments would have been reported in the specialized columns called for under proposed Item 402(c)(2)(vi) and (vii).[46] If the item is intended to cover simple discounted purchases of unrestricted stock pursuant to arrangements that do not have option-like features, service or performance conditions, our understanding is that such arrangements are not subject to FAS 123R, and accordingly the item should call simply for disclosure of the dollar amount of any discount.

We discuss the proposed perquisites disclosure in Part III of this Letter.

The Commission's suggestion to include a separate table detailing the components of the All Other Compensation column is appropriate. However, because the types of compensation included in this column vary so widely and because they may change over time, a separate table should remain a recommendation rather than a requirement, or should be required only if more than a specified number of payment categories – such as five – are disclosed. The second sentence to the All Other Compensation column under existing Item 402(b)(2)(v) should be retained under proposed Item 402(c)(ix) to specify that the disclosure in the footnote to the SCT identifying and quantifying various elements of All Other Compensation is required only for amounts reported in the column for the last fiscal year.

D. Supplemental Annual Compensation Tables

In addition to our comments above regarding the treatment of incentive plan awards, we have the following comments on these tables.

1. Grants of Performance-Based Awards Table

Instruction 4 to Item 402(d), which states that repriced options are to be reported in the Grants of Performance-Based Awards table, should be deleted. The same Instruction appears as Instruction 3 to the Grants of All Other Equity Awards table, which appears to be the appropriate location for the Instruction.

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members often advise our clients as to the appropriateness of providing disclosure beyond that which is mandated under the existing rules.

[46] Proposed Instruction 1 to Item 402(c)(2)(ix) should be expanded to refer to "amounts received on exercise of options and SARs <u>and upon vesting of other stock awards</u> are required to be reported elsewhere..."

2. Grants of All Other Equity Awards Table

This table should be reformatted in order to promote clarity and usefulness, as follows:

- Grant date should be the second column, consistent with the presentation of the year in the SCT.

- A column should be added at the far right for disclosing the grant date fair value of each award. This will assist readers in understanding how the awards reported in this table tie to the value reported in the SCT. We believe that the assumptions used in valuing options should be disclosed in footnotes to this table, instead of having that information in the notes to the SCT or incorporated by reference from the company's financial statements, since different assumptions may apply to different grants. The second sentence of Instruction 2 to proposed Item 402(e) would be revised to allow awards to be aggregated only if granted on the same day and subject to the same FAS 123R assumptions.

- The Vesting Date column should be deleted because that information is required to be described in narrative text accompanying the table pursuant to proposed Item 402(f)(1)(iii). In addition, vesting information typically cannot easily be reported on a single line in a table since vesting often occurs over a period of time. Similarly, there is no reason to have material terms of awards discussed in footnotes to the Grants of All Other Equity Awards table when material terms to awards reported in the Grants of Performance-Based Awards table appear in the narrative text. Therefore, proposed Instruction 4 to Item 402(e) should be deleted and instead Item 402(f)(1)(iii) should be expanded to require narrative description of the material terms of any award reported in response to either paragraph (d) (the Grants of Performance-Based Awards table) or paragraph (e) (the Grants of All Other Equity Awards table).

- We do not believe that it is necessary to add additional columns to separately identify performance-based stock awards.[47] Any performance conditions can be described in footnotes or narrative text accompanying the table. For arrangements where the number of shares may be increased or decreased based on the extent to which performance goals are satisfied, the number of shares reported in the table should be based on the same standard applied for purposes of the company's FAS 123R calculations.

- Proposed Instruction 6 should be deleted. That Instruction specifies that closing price on grant date is to be used "in determining if the exercise or base price of the options, SARs and similar option-like instruments is less than the market price on the date of grant." Many companies use other reasonable methods to determine exercise price, such as

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[47] As noted earlier, we also do not believe that it is necessary to set forth a special category or definition for stock-based incentive plan awards.

average of high and low price or volume weighted average price. Other than this proposed Instruction, there is no other securities, accounting, tax or other standard that establishes closing price as the appropriate measure of market price for an option grant, and the Commission has not enunciated any basis for changing the rule under current Instruction 6 to Item 402(c), which allows a registrant to use either the closing market price per share of the security or any other formula prescribed for the security. In addition, the Commission could specify that the standard applied by a company for determining market price is a material term of the award that is to be addressed in narrative disclosure accompanying the table.

E. Narrative Disclosure to Summary Compensation Table and Supplemental Tables; Compensation Disclosure on Non-Executives

We do not believe that the Commission should require disclosure of up to three non-executives' compensation. The Commission has not provided an explanation of why the fact that these expenses' status as compensation justifies disclosure of the information or distinguishes this expense from any other category of expense incurred by companies in the course of engaging in business (such as amounts paid to an individual to purchase a business or to license intellectual property from the individual). Because the recipients of such amounts by definition do not have a policy-making function, there is no corporate governance nexus to the proposed disclosure.[48] In contrast to the situation with executives and directors of public companies, we believe that individuals whose compensation would be disclosed have legitimate privacy expectations and that companies have legitimate competitive concerns that would be undermined as a result of the proposed disclosure.[49] Particularly when weighed against the utility of the proposed disclosure, gathering the information that would be required under this proposed disclosure would be expensive and time-consuming for many companies that rely on human talent and would require extensive interpretive guidance from the Commission on how to characterize and quantify financial arrangements that are not common in the context of executive compensation, such as commissions, royalties, advances and payments to personal service companies.

In addition to comments elsewhere in this letter, we have the following comments on the proposed narrative disclosure requirement:

- The terms of an executive's employment agreement frequently do not directly relate to information disclosed in the tables under proposed Items 402(c), (d) and (e), and such agreements often contain information relevant to other proposed disclosures (such as the

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[48] Often, the compensation arrangements for such individuals are neither reviewed nor approved by a company's board of directors or board compensation committee, because they do not implicate the policy or related–party aspects of directors' and executives' compensation.

[49] In many cases, descriptions of the individuals' job positions would be sufficient to assist competitors in identifying the individuals or would be so vague as to raise even greater questions as to the utility of the proposed disclosure.

severance and change-in-control disclosures under proposed Item 402(k)). Instead of having the description of such agreements scattered around various tables, we believe that a separate disclosure item comparable to Item 402(h)(1) should be retained. We believe that this approach is more effective than the proposed check mark in the SCT to indicate the existence of an employment agreement.

- The language in proposed Item 402(f)(1)(iii) calling for disclosure of "the applicable dividend rate" will not produce useful information when the dividend rate is not preferential. Instead, proposed Item 402(f)(1)(iii) should be revised to read, "For example, state where applicable that dividends will be paid on stock (including restricted stock, restricted stock units or other similar instruments), whether or not that rate is preferential (and if so, what the preferential rate is) and whether or not dividends are deemed to be reinvested and/or are subject to any conditions."

- Proposed Instruction 2 to Item 402(f)(1) has an inaccurate cross-reference; it should refer to paragraph (f)(1)(ii) of the Item and not to paragraph (f)(2).

III. Perquisites Disclosure

We believe that the treatment of perquisites and other personal benefits in the Proposals is, in general, constructive and appropriate. We agree with the Commission that the subject of perquisites and personal benefits is important to investors and that companies should approach this subject thoughtfully. We also agree that, in light of the wide variety of perquisites, the continuation of the "incremental cost" approach is consistent with existing practices and provides a reliable basis for presentation of the compensation items that fall within this category.[50] Although the Commission's discussion and examples of perquisites in the Proposing Release provided some assistance in interpreting the disclosure requirements, we believe that additional refinements in the interpretation would be helpful. We also recommend that the Commission provide additional guidance and structure for valuation of company-provided aircraft, and simplify the proposed threshold for itemized, quantified disclosure.

[50] The existing and proposed rules under Item 402 value compensation based on the amounts received by an executive and, when that is not readily available, the cost to the company. For example, the FAS 123R value proposed for equity awards can be equated with a measurement of cost to the company. *See* Staff Accounting Bulletin 107 ("The estimate of fair value represents the measurement of the cost of the employee services to the company.") In addition, as recognized by the Commission in the Proposing Release, perquisites typically benefit a company by facilitating job performance. Thus, we do not believe it is appropriate to attempt to devise a method of valuing perquisites based on some proxy for estimating market value.

A. Identification of Perquisites

We appreciate the Commission's recognition that over the past 25 years since the Staff last issued interpretive guidance on the definition of perquisites,[51] difficult questions have continued to arise. We agree that, because the determination of whether a particular item is a perquisite is so dependent on the context, it is not possible to set forth a bright line definition that will appropriately apply across all circumstances. The difficulty arises both because of the wide variety of items that in a particular circumstance may be considered a perquisite and because advancing technology and business demands have increased the extent to which work is conducted outside of the traditional office environment and around the clock.

The Proposing Release sets forth a two-part test for determining whether an item is a perquisite, the first of which focuses on whether a benefit is "integrally and directly related to the performance of an executive's duties." If an item fails to satisfy the "integrally and directly related to" job performance test, under the Proposing Release, companies must determine whether the item confers a "direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees." During the 2006 proxy season, we found that this approach has not been particularly helpful to companies and their advisors in determining what is a perquisite.[52]

As suggested by the reference to "other personal benefits" under both the current and proposed rules, we believe that the Commission should refine its guidance to focus on the central importance of the personal aspect of the item in analyzing whether an item is a perquisite. Unless there is a substantial personal benefit aspect to the item, it should not be viewed as a perquisite even if it only "facilitates" job performance. In lieu of the two-part test in the Proposal, we recommend the following formulation:

> "An item is a perquisite if it confers a substantial personal benefit. In determining whether a personal benefit is substantial, the registrant must evaluate whether the personal aspect of the item is disproportionate to the business context or the benefit of the item to the registrant. In weighing these considerations, an item that confers a benefit that is entirely personal, or where such aspect predominates, would normally be considered a perquisite. In contrast, an item that is provided primarily to enable the executive to perform his duties or

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[51] The Staff last issued interpretations on what constitutes a perquisite in 1981, in Securities Act. Rel. No. 6364 (Dec. 3, 1981).

[52] The concept of "integrally and directly related to performance" has proven elusive. For example, it suggests that whether a benefit is provided to or used by all similarly situated executives is a relevant factor. Likewise, determinations under the second prong of the Proposing Release's guidance are difficult, since by definition the whole inquiry is only being raised because an item has a "personal aspect."

> conduct business or that otherwise is primarily for the benefit of the registrant generally would not be considered a perquisite, even if it results in an incidental personal benefit."

Under our suggested approach, when an item contains both business and personal aspects, companies must apply a balancing test to determine whether the item confers a benefit that has a predominantly personal aspect. If so, then the item is a perquisite, and the incremental cost of the personal aspect must be disclosed as part of the executive's compensation. Relevant factors include:

- Whether the item is related to the performance of the executive's duties and, if so, the nature of the relationship and whether the personal aspect of the item outweighs the business context such that the overall effect of the item is more business than personal; and
- Whether the reason that the item is not provided to all employees is because it is intended to compensate or reward the executive.

This approach would focus the inquiry on the personal aspect of the item and avoid the need to analyze whether an item should be considered "integrally and directly related" to job performance.

We believe that most of the items identified in the Proposals as perquisites would also qualify as perquisites under this suggested standard because these items have a predominantly personal aspect, outweighing any business purpose or other rationale for such benefits, including: personal financial or tax advice; personal travel using vehicles or aircraft owned or leased by the company (regardless of any security rationale for such travel); personal travel paid for by the company; personal use of property owned or leased by the company (regardless of any security rationale for such use); housing and other living expenses (including relocation assistance and payments for the executive to stay at his or her personal residence); commuting expenses; and discounts on the company's products or services not generally available to employees on a non-discriminatory basis.

We discuss below several types of benefits and whether they would constitute perquisites under our proposed standard.

1. Use of Corporate Aircraft and First-Class Business Travel

Under our suggested approach, neither the use of corporate aircraft for business travel nor first-class business travel is a perquisite. The fact that the executive must travel from point A to point B in order to conduct business outweighs whatever personal benefit he or she receives by traveling on corporate aircraft or on first-class commercial aircraft.

2. Business Entertainment with a Spouse or Significant Other

The conduct of business sometimes entails business entertainment, such as a dinner, with spouses or significant others present. In our view, if the predominant purpose of the entertainment is business – that is, the primary reason for the occasion is to foster business relationships, then the personal aspect is only incidental. Neither the presence of spouses or significant others nor the social/entertainment nature of the occasion changes the overall characterization from a business expense to a perquisite. However, this conclusion could differ if the context suggests that the event is not primarily advancing the conduct of business, such as a birthday party for an executive's spouse.

3. Mobile Office Equipment

A company-provided PDA with email capability provides a benefit to the company from ensuring accessibility of the executive. The fact that the device works both during business travel and at home, and for both business and personal messages does not make it a perquisite.

B. Valuation

As noted above, we agree that the best approach to valuation continues to be the "incremental cost" method. However, application of this method to valuing compensation attributable to executive use of company-provided aircraft for personal travel continues to present unresolved issues. These difficulties arise from the wide variety of ownership and leasing structures, record-keeping systems and aircraft types that exist in practice.

The wide variety of circumstances makes it difficult to select a uniform valuation method. We do not think it would be possible to prescribe a uniform procedure to determine whether a particular cost item should be included in incremental cost. We suggest instead that the Commission allow the valuation practices already evident in a number of recent proxy statements to develop by encouraging footnote disclosure of specific valuation methods for calculating incremental cost where material aspects of the methodology exist. We believe that ongoing disclosure in this manner over time is likely to produce a consensus approach among registrants that are similarly situated. At the same time, this transparent approach leaves room for the Commission and its Staff to provide further guidance in order to eliminate any inconsistencies or misconceptions that might develop in the future.

If this approach to footnote disclosure is adopted, additional refinements should be considered. First, the Commission should expressly state that there is no requirement to use the same methodology every year or to restate prior amounts if a change in methodology is adopted. This approach encourages companies to develop and refine their determination of incremental cost over time and to remain consistent with developing practices without the concern over whether the company is able to apply the new methodology over all three years covered in the SCT.[53] Also, the Commission should expressly state that where the level of personal use is secondary to the overall use of company-provided aircraft there is no requirement to allocate a portion of the fixed cost of company-provided aircraft to private use when determining incremental cost. This treatment enhances comparability of this information among companies and helps resolve existing uncertainty that results in inconsistent valuation practices.

C. Thresholds

The Commission has specifically requested comment on the determination of perquisite thresholds. We believe the threshold approach included in the Proposing Release should be clarified and simplified. The proposed thresholds are summarized as follows:

- **Table Amount.** Perquisites must be reported in the SCT in the All Other Compensation column unless the aggregate amount of all perquisites for an NEO is less than $10,000.
- **Footnote Disclosure.** All perquisites reported in the SCT must be identified by type. In addition, each perquisite that exceeds the greater of $25,000 or 10% of the total amount of perquisites for an NEO must be identified and quantified.

We support the Commission's approach to require reporting in the SCT for aggregate perquisites based upon a threshold that is a fixed dollar amount, such as $10,000 per individual. However, we also recommend the Commission use a fixed dollar amount threshold for footnote disclosure of perquisite amounts and eliminate the alternative percentage test for quantifying perquisites. Otherwise, the proposed use of a percentage threshold results in anomalies because the level of detail provided on perquisites will vary among NEOs at the same company and diminishes to the extent that one NEO is provided a perquisite (such as use of the corporate aircraft) that has a high value and that predominates over other perquisites. In contrast, a single, fixed dollar threshold for footnote disclosure would be more effective in providing a clear line of sight to corporate policy-makers, individual executives and shareholders. Thus, in any case where an individual's total perquisites exceeded the initial fixed dollar threshold (*e.g.*, $10,000) so that the amounts would be included in the SCT and identified by type in a footnote, each particular type of perquisite exceeding the fixed dollar amount for footnote detail (*e.g.*, $25,000) would be required to be identified and quantified in a footnote.

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[53] The Staff adopted a similar position in Staff Accounting Bulletin 107 where it stated at Question 3 Section C, "A change in the valuation technique or model used to meet the fair value measurement objective would not be considered a change in accounting principle. As such, a company would not be required to file a preferability letter from its independent accountants as described in Rule 10-01(b)(6) of Regulation S-X when it changes valuation techniques or models."

IV. Exercises and Holdings of Previously Awarded Equity

We believe that the proposal to report holdings of and amounts realized under previously awarded equity arrangements in two separate tables will provide useful information for investors and appropriately eliminates the existing disparate disclosure requirements between options and other equity awards.

A. Outstanding Equity Awards at Fiscal Year-End

The proposed format provides a concise and easy-to-comprehend summary of the NEOs' holdings of unvested and unexercised equity awards. We believe that intrinsic value, and not fair value, is the appropriate standard to apply for reporting the value of outstanding awards, as this information is most readily understood by investors as a measure of outstanding option value. As with our recommendation for reporting the grant of equity awards where the number of shares to be received may vary based upon the extent to which performance conditions are satisfied, the number of share "holdings" reported under such arrangements should be based upon the same standard applied for accounting purposes; *i.e.*, the number of shares considered "probable" of being earned as of the fiscal year-end measurement date. We agree that equity awards that have been transferred without consideration should continue to be included in the table, but believe that the transfer of an award for value (such as pursuant to the type of option buy-out program conducted a few years ago by Microsoft Corporation) should be reported in the Option Exercises and Stock Vested table as the realization of value from the award and that the award that was sold should no longer be included as an outstanding award included in the table.

We are aware that some commenters have called for more detailed information to be presented in this table, such as a grant-by-grant presentation. In light of the fact that options may be held for a ten-year term and that executives often hold numerous grants, we believe that providing more detailed information in the proxy statement would reduce the utility of the table for a great many investors who are focused on aggregate option value under equity awards. For the same reason, we believe that Instruction 2 to proposed Item 402(g)(2), which would effectively require grant-by-grant information on expiration dates in a footnote to the table, should not be adopted because the usefulness of this one piece of information to most investors is questionable and the proposal risks voluminous and unwieldy disclosures. If the Commission determines that such grant-by-grant information nevertheless should be disclosed, companies should be provided the option of providing the aggregated holdings information in their proxies under the format set forth in the Proposals, and posting grant-by-grant information on their corporate website.

The proposal under Instruction 2 to require supplemental information on the post-fiscal year-end status of a particular sub-class of options (those expiring after the end of the fiscal year but prior to some unspecified "subsequent" date) represents an unusual and unjustified deviation from the standard of presenting compensation information only for the last completed fiscal year, and therefore should not be adopted.

B. Option Exercises and Stock Vesting

As noted above, we support this proposed table. However, we believe that the Commission should not adopt the proposed requirement to report previously disclosed grant date fair value of exercised or vested awards in the last column of the table. The column should not be required because it presents valuations on a different basis than what is presented in the earlier columns and therefore may be viewed inaccurately as reporting an NEO's gain or loss on a transaction, and may be viewed as suggesting that a company did not accurately portray grant date fair value.[54] In addition, in many cases a grant-date fair value for an award may not have been previously reported in the SCT – either because the award was granted sufficiently before a company adopted FAS 123R or because the award was granted in a year when the individual was not an NEO – resulting in differing levels of disclosures as between various grants and NEOs, and thus haphazard and inconsistent disclosures. Eliminating the column as a requirement will not, of course, prevent companies from voluntarily including this information should they wish.

V. Post-Employment Compensation

A. Retirement Plan Potential Annual Payments and Benefits Table

As a preliminary matter, we note that in designing rules for the disclosure of pension benefits, presentation of the value of benefits is more difficult to achieve than for other forms of compensation and comparability of presentation is even more elusive. This is because the calculation of benefits (and conversions of a benefit from one form to another) is heavily dependent on the actuarial assumptions used, form of benefit provided and marital status, which will generally differ from plan to plan and company to company. In addition, benefits of equivalent actuarial value will generally result in different annual amounts payable to an executive, depending upon the form in which the benefit is paid.

We believe that the benefit shown in the Retirement Plan Potential Annual Payments and Benefits table ("Pension Table") should be the benefit payable assuming the executive had terminated employment on the last day of the prior fiscal year (rather than a projection of the benefit that would have been payable had the executive continued in employment until the normal retirement date). The benefit earned through the end of the prior fiscal year (payable at retirement) is a more appropriate reflection of the value of the benefit that has been earned by the executive at the time the proxy statement disclosure is presented than is a projection that requires assumptions as to additional years of service and levels of compensation. As we discuss below in the context of change-in-control and other post-employment benefits, compensation disclosures have traditionally been based upon amounts earned or accrued as of the end of the

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[54] In Staff Accounting Bulletin 107, at Question 1 of Section C, the Staff stated that, as long as a company reasonably and appropriately determines grant date fair value, "changes in an employee share option's value, no matter how significant, subsequent to its grant date do not call into question the reasonableness of the grant date fair value estimate."

last fiscal year.[55] The one exception has been in the existing defined benefit plan disclosure requirement under Item 402(f), which has required an estimated benefit table that would show the benefit payable based upon a range of years of service and covered compensation. Proposed Item 402(i) would not change the speculative nature of that disclosure, but would arbitrarily compel the selection of a single year of service assumption (based on an assumption that the executive will continue in service until retirement age) and covered compensation assumption.[56] While this may increase comparability of the disclosures across executives and companies, it achieves that goal by sacrificing relevance as to the executive's actual status. The more assumptions that need to be applied in presenting the disclosure required under this item, the more speculative and complex the disclosures.[57] The table would not show an "estimated" benefit; it would show a hypothetical benefit.

For technical reasons, as well as to increase comparability from company to company, we recommend that the Pension Table reflect the benefit in the standard form of a single life annuity commencing at age 65, instead of in the form elected by the executive or the plan's "normal form" of benefit. This is because tax-qualified pension plans typically do not permit elections as to form of benefit until 90 days before the pension payments are scheduled to begin. Many non-qualified plans that supplement qualified plans currently provide that the qualified plan election will also govern the supplemental plan.[58] Calculating benefits in a plan's "normal form" would reduce comparability as between NEOs, since under tax-qualified plans the normal form depends on the participant's marital status.

If an NEO participates in a plan that provides alternative benefit forms that are not actuarially equivalent to the form shown in the Pension Table (in other words, if the plan offers a "subsidized" form of benefit), the availability of the additional benefit form(s) should be described in the narrative disclosure and the approximate value of the NEO's normal retirement benefit under the most valuable of such forms should be either footnoted or shown in an

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[55] In our comments below, we recommend that change-in-control and other post-employment benefits likewise be presented as of the end of the last fiscal year. Applying this approach consistently has the compelling benefit of enabling companies and investors to pull together and compare on an "apples-to-apples" basis all of the various compensation disclosures presented pursuant to Item 402.

[56] In this respect, proposed Item 402(i) actually reduces the extent of disclosure by eliminating the table and presenting a single coordinate from it based on the prescribed years of service and covered compensation assumption.

[57] This is particularly the case where, as discussed below, an NEO participates in a number of different plans, but due to "offset" features in such plans will only receive the benefits based upon the greatest amount determined from among the different plans.

[58] This practice may change as a result of recently enacted Code Section 409A. Proposed regulations under Code Section 409A would significantly restrict elections with respect to timing and forms of benefit under non-qualified plans, but it is possible that the final regulations may permit some choice of benefit form to be made immediately prior to retirement, at least among actuarially equivalent annuity forms.

additional column in the table. If a particular plan has a normal retirement date other than age 65, this could be footnoted, but should not need to be quantified as long as the benefit is actuarially equivalent to that shown in the Pension Table. A similar approach should be taken with respect to early retirement benefits. The narrative disclosure should state the earliest age at which an executive could retire under the plan; however, a company should be required to disclose the value of the benefit payable at early retirement only if the benefit is subsidized (*i.e.* greater than the actuarial equivalent of the plan's normal retirement benefit) and if the executive is entitled to receive such subsidy; otherwise it should be sufficient to state that the benefit is the actuarial equivalent of the normal retirement benefit, reduced to reflect the earlier starting date. If the early retirement benefit is subsidized, the narrative disclosure should include the manner in which such benefit is determined.

If the plan permits payments to be made in a lump sum, we agree that the amount of each executive's lump sum benefit should be required to be provided, with disclosure of the assumptions used to calculate the amount and whether the lump sum is payable upon termination of employment or only at a specified retirement date.[59]

We believe that a company should <u>not</u> be required to disclose a lump sum present value of a retirement benefit where the plan does not permit payment in that form. In such a case, the plan would not have mortality and interest rate assumptions that could be used to convert the benefit to lump sum form, and unless the Commission chooses to prescribe the assumptions to be used for this purpose, any choice of assumptions would be arbitrary.[60] Moreover, the disclosure could leave readers with the incorrect impression that executives would be entitled to receive a lump sum benefit when in fact such a benefit was not available to them.

The proposed requirement to present information for each plan in which an NEO participates results in difficult to understand and possibly duplicative disclosures when the multiple plans have "offset" features or provide alternative benefits. This situation may arise when a company has altered its benefit formula under a plan but "grandfathered" the benefit available to existing participants, adopted a different form of plan, adopted a supplemental plan that makes up for benefits limited by tax code provisions under another plan or assumed another plan in a merger. Under such arrangements, an executive may be a participant in more than one plan, but the amount of the benefit that he or she receives will be the greatest amount determined under only one such plan; that benefit either will be offset by amounts received under other plans or will be

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[59] If a plan provides for payment only in the form of a lump sum, there is an issue as to what assumptions should be used to convert that benefit to an annual benefit in the Pension Table. One possible approach is to report such benefits in their lump sum form in a separate column of the Pension Table instead of prescribing assumptions and requiring them to be converted to and presented as an annuity.

[60] Although Code Section 417(e) specifies actuarial assumptions that must be used in converting qualified plan annuity benefits to lump sum form for purposes of calculating the minimum and maximum permissible amount of the lump sum benefit, we believe such assumptions should not be used for this purpose because these assumptions have been generally viewed as resulting in an overstatement of the value of the lump sum benefit.

provided to the exclusion of lower benefits that might be available under a different plan. In such cases, a company should be required to present in the Pension Table only the aggregate benefit that an executive would actually be able to receive and should not be required to allocate those amounts from among the various offset plans or to present the lesser benefit that an executive will not receive from an alternative plan. The narrative or footnote description accompanying the Pension Table could, however, identify the various plans and briefly describe their interaction.

We agree that there should be narrative or footnote disclosure if an NEO's credited service under a plan differs from his or her actual service, including the reason for such difference. However we believe that a general statement of the company's "policy" regarding credited service will not provide any additional meaningful information.

We recommend that the narrative disclosure to the Pension Table be limited to the specific matters noted above, the vesting requirements under the plan, and any other information necessary to clarify the information in the table. In particular, we believe the Commission should not adopt a requirement to provide a general description of the material terms and conditions of the plan, benefit formula, eligibility standards and the specific elements of compensation included in the benefit formula, as those disclosures in many cases could run for many pages. For example, it is not unusual for a qualified plan and the non-qualified plans that supplement it to compute a benefit based on a number of alternative formulas, often due to historical factors such as mergers or tax law changes. Disclosure of the "benefit formula" would thus require extensive disclosure in order to be accurate, but would in the end not provide much meaningful information beyond the benefit computation already reflected in the table and accompanying footnotes. While narrative disclosure of the relationship between various plans might help the reader understand the nature of the retirement benefits being provided, and should be encouraged, we believe a requirement to disclose "the reasons for each plan" will only result in boilerplate.

Finally, we would suggest that the name of the table be shortened to "Pension Benefits."

B. Nonqualified Defined Contribution and Other Deferred Compensation Plans Table

We agree that there is keen interest in some quarters for increased disclosures of the full amount payable to NEOs under nonqualified defined contribution and deferred compensation plans, but recognize that there is debate as to what information other than the year-end account balance should be disclosed. As discussed earlier, we believe that employer contributions or allocations to an NEO's account and preferential earnings and rates of return under such plans represent clear elements of compensation or compensatory benefits that should be disclosed in the SCT. Beyond that, we believe that it is a legitimate view that the significant aspects of such arrangements relate only to the extent to which an executive has in effect loaned the company money by deferring current compensation and the extent to which the executive is a creditor to the company through his or her aggregate account balance as of the end of the last fiscal year.

Information on increases or decreases in the account balances due to investment performance, on the other hand, do not reflect compensation determinations; when returns under such plans are not preferential, the utility to the public of the year-to-year investment performance of the measures selected by an NEO from among those offered by a company is questionable and has not, to our knowledge, been addressed. Thus, in addition to the amounts that we believe should be disclosed with respect to such plans in the SCT, we believe that the essential elements of disclosure with respect to nonqualified defined contribution and other deferred compensation plans are the amount deferred by the executive in the last fiscal year, the aggregate employee contributions[61] to the plan and the aggregate balance at the end of the last fiscal year.

If, however, the Commission determines to adopt the proposed Nonqualified Defined Contribution and Other Deferred Compensation Plans table, we believe that many companies will add an additional column to reflect the aggregate balance as of the beginning of the last fiscal year, so that the Aggregate Earnings column is put into a proper perspective. We suggest also that the column heading "Registrant contributions in last FY" be changed to "Employer contributions in last FY" to clarify that contributions by subsidiaries of the registrant are also included.

The proposed Instruction to Item 402(i)(2) should not be adopted. It typically would be impossible to report the amount of contributions and earnings that had previously been reported as compensation in the SCT, both because the executives may not have been NEOs in the prior years and because account balances represent increases and decreases in earnings over the term in which an executive has been a participant in the plan and cannot readily be attributable to a specific year. Likewise, companies should not be required to provide a footnote to this table tying amounts back to the SCT. The footnote to the SCT showing amounts that are deferred sufficiently informs investors that the NEO has not actually received all of the amounts reported in the SCT, and for companies that allow deferral of amounts earned upon the vesting of restricted stock units or the exercise of options, the proposed footnote will not capture the full amount contributed by an executive. Thus, although we recognize the proposed Instruction is an attempt to avoid "double-counting," we believe that companies will be able to address such concerns through their narrative descriptions without the need for an instruction mandating an effort at numerical reconciliations.

We agree that the narrative disclosure should include the types of compensation permitted to be deferred and any limitations on the amount that can be deferred, as well as the material terms with respect to payouts. With respect to the manner of calculating plan earnings, an instruction should provide that if earnings are determined by reference to actual earnings of mutual funds or other actual investments, it should be sufficient to make a statement to that effect without

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[61] The employer obligation under a plan is the difference between the amount the executive has contributed to the plan and the account balance. Because amounts credited to the plan may increase or decrease in value from time to time based upon the performance of the medium in which the balances are deemed to be invested, the employer's obligation does not correspond to an "employer contribution" amount.

identifying the actual investment measures selected by an executive or quantifying earnings rates beyond the dollar amount of earnings shown in the table. Otherwise, the disclosures could be extremely extensive and burdensome, because many companies offer a wide range of investment alternatives, the "earnings" on those investments may reflect both dividends and changes in the value of the investment funds, and the measure of returns would vary depending on whether an executive reallocated some portion of his or her account balance into or out of the fund as of a particular time during the year. In addition, the narrative disclosure should state whether plan benefits are funded and the nature of the funding vehicle (*e.g.* rabbi trust, secular trust, etc.), and if the funding vehicle is taxable, who pays the tax. We believe a description of other tax consequences of participation in the plan is not necessary to an understanding of this type of plan and would generally result in only boilerplate disclosure. However, any tax "gross-up" should be required to be disclosed.

VI. Other Potential Post-Employment Payments

The proposed disclosure of other potential post-employment payments should be provided as of the end of the registrant's last completed fiscal year, for the following reasons:

- By specifying the calculation date in the rule, the resulting disclosures will be more useful to investors, as investors will be able to compare the level of benefits both among NEOs at a single company and across companies. Conversely, without specifying the calculation date, the assumptions as to when termination dates might reasonably occur – and thus the bases upon which the disclosures are calculated – would differ wildly as between NEOs and companies without improving the quality of the disclosures, since any projected termination or change-in-control dates would almost certainly not prove accurate unless an NEO's termination of employment or a change-in-control transaction had already been announced.

- It is inappropriate to require companies to make a reasonable assumption as to when each of their NEOs might be terminated for cause, quit or be fired without good reason or otherwise terminate employment, and to make a reasonable assumption as to when a change in control may occur. Requiring disclosure of the bases underlying those assumptions would require companies to engage in pure speculation since, by definition, many of the scenarios will never transpire (for example, an NEO cannot both be terminated by the company for cause and be terminated without good reason). In many situations, the most reasonable assumption will be that some of the circumstances that trigger post-employment payments will never occur, and yet we do not expect that the Commission's goal is for companies to avoid disclosures relating to those termination scenarios. Similarly, it is inappropriate to require companies to make assumptions as to the value of their stock as of some hypothetical future date for purposes of quantifying the impact of termination scenarios and a change in control on the value of equity-based benefits.

- The number and variety of assumptions underlying the proposed disclosures may necessitate extensive disclosure of "meaningful cautionary statements" identifying important factors that could cause material differences from the amounts disclosed in order to obtain the benefits of the safe harbor for forward-looking statements.

- Even with the benefit of the safe harbor for forward-looking statements, the proposed disclosure unnecessarily increases companies' exposure to litigation should a triggering event occur at a different time or the value of benefits differ from those previously disclosed. Because of the speculative nature of the proposed disclosures, the amounts to be received by NEOs when a termination or change in control actually occurs will almost certainly differ from amounts that would be disclosed pursuant to proposed Item 402(k).[62] It is possible that lawsuits would be filed asserting, with the benefit of hindsight, that a company's assumptions were not reasonable and therefore that its disclosures were materially misleading. Even though companies might ultimately prevail in demonstrating that their assumptions were reasonable, the fact-intensive nature of the issue would prevent such cases from being capable of resolution at the summary judgment or motion to dismiss stages, resulting in lengthy and expensive litigation that would not benefit the company's stockholders.

- Requiring amounts to be calculated as of the end of the registrant's last completed fiscal year will better integrate the disclosures with other disclosures pursuant to proposed Item 402. For example, the value of equity awards that might vest upon a specific event would tie with the year-end value of unvested awards reported pursuant to proposed Item 402(g).[63] In addition, the costs to companies of providing the disclosures as proposed would be significant. For example, under the Proposals, a company would need to calculate the value of each NEO's pension benefits as of the end of the last fiscal year (for the SCT), as of normal and early retirement dates (for the Pension Benefits Table) and as of a variety of projected "reasonable termination" dates that would fall between the end of the last fiscal year and the NEO's retirement date. Each of these disclosures would require numerous assumptions and would involve calculations that a company often would not otherwise perform.

Regardless of whether presented as a hypothetical calculation as of the end of the last completed fiscal year or as of some speculative future date, the quantification of benefits required under proposed Item 402(k) should be deemed "furnished" and not "filed" with the Commission.

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[62] Among the factors affecting amounts payable are the executive's actual termination date, the value of stock and other elements of compensation (such as a deferred compensation plan account balance that changes daily based upon the performance of underlying investments) and the elements of compensation upon which such payments are based (for example, an NEO's salary rate in effect on a termination date, whether existing equity awards have already otherwise vested as of a future date or whether new equity awards have been granted).

[63] As stated above, we recommend that retirement plan potential annual payments and benefits likewise be disclosed based upon the benefit accrued as of the end of the last fiscal year.

While "furnished" status would maintain companies' anti-fraud liability for the disclosures, it is not appropriate to subject underwriters and other offering participants to potential Securities Act liabilities and due diligence requirements with respect to these complex calculations, which will require knowledge of the terms of employee benefit plans, grants under individual plans, terms of employment agreements and determinations of actuarial assumptions.

The proposed quantification of benefits should apply only to the PEO and the narrative description of the arrangements should apply to all of the NEOs. As reflected by the Commission's request for comment on proposed Item 402(k), the item (regardless of whether presented as a table or narrative text) would require separate disclosures for cash payments, stock payments and other benefits, separate disclosures for each potential termination event, and further disclosures of other material terms, such as duration and applicable covenants. While some companies have in recent years begun to present calculations or estimates of the value of these benefits to their board compensation committees, most companies have not performed calculations with the specificity that would be required under proposed Item 402(k), and many of the companies that have undertaken the calculations have done so only for the PEO, because compensation committees recognize that the precise value of benefits will vary based on a wide variety of factors and the estimates generally are viewed as sufficient to enable the directors to fulfill their duties. Given the complexities involved and the fact that the individuals who are NEOs in a particular year, other than the PEO and PFO, may not be known until around the time that the proxy statement is being prepared, imposing an obligation on companies to identify and quantify numerous benefits in a variety of scenarios for each NEO will require a much greater effort and expense in a very compressed time period. In contrast, because the PEO is readily identified and because the benefits payable to the PEO typically will exceed those payable to other NEOs, the additional burden of requiring the proposed quantification with respect to the PEO is not as great. Finally, because the disclosures (regardless of methodology applied) will not reflect the actual amounts an executive ultimately receives when a termination of employment or change in control occurs, we believe that disclosure of the post-employment benefits payable to the PEO – which typically will exceed those payable to other NEOs[64] – together with the proposed narrative description of other NEOs' post-employment payments, provides investors a greatly enhanced basis for understanding the level of such benefits without imposing extraordinary costs and hardship on companies that the additional hypothetical calculations would entail.

In addition, Item 402(k) should permit companies to disclose an estimated range of the amount of any "golden parachute" tax gross-up payments because of the complexity of calculations and

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[64] The most common instance in which another NEO might receive greater post-employment benefits than the PEO is when another NEO has accrued a large pension plan and/or deferred compensation benefit based upon years of service and/or performance of plan investment vehicles. We do not believe the fact that pension or deferred compensation benefits may result in higher post-employment benefits for some NEOs other than the PEO justifies requiring quantification of all NEOs' post-employment payments, as the pension or deferred compensation benefits will be quantified for all NEOs under other parts of proposed Item 402.

the number of assumptions as to tax treatment of various payments that are necessary in this context.[65] To this end, the Instructions to Item 402(k) should also specify that any assumptions used by the company in calculating the amount of tax gross-up payments (such as whether certain benefits constitute reasonable compensation for services rendered after the change in control) may be stated generally instead of being specifically enumerated.

We have the following additional comments on proposed Item 402(k):

- The item should not apply to NEOs whose employment has in fact terminated other than with respect to disclosure applicable to the actual circumstances of their termination. To the extent that actual post-employment payments are quantified in the All Other Compensation column of the SCT, it should not be necessary to repeat the amounts pursuant to Item 402(k). Likewise, if an NEO has retired before the proxy statement is filed, a company should not be required to disclose the amount the NEO would have received if the NEO had been terminated for cause or if a change in control had occurred before the NEO retired.

- We believe that the concept of presenting this information in a table will assist in clear and understandable presentation, and in cross-referencing quantifications that appear in other disclosures pursuant to Item 402 (such as payments of benefits or account balances under pension and deferred compensation plans and the value of stock awards that may vest upon a triggering event). However, this approach is practical only if companies are able to group similar types of triggering events. As noted earlier, it is not uncommon for companies to employ a variety of definitions of "change in control," "cause," "retirement," etc. If each of these requires a different column or row in the table that may be applicable to only one plan or form of benefit (for example, the definition of retirement used in the equity compensation plans might be applicable only to those plan benefits), then a table would quickly become unwieldy. If a company can, however, group all "change-in-control" payments into a single column or row, "retirement" in a single column or row, etc., with footnote descriptions of the various triggering events (see our comment below), then a tabular presentation will be useful.

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[65] While the complexity can arise from many aspects of these arrangements, such as differing definitions of "cause" or of "change-in-control" under various benefit plans and employment agreements, it is particularly acute with respect to "golden parachute" tax gross-up calculations. For example, the applicability of Code Sections 280G and 4999 (the "golden parachute tax" provisions) requires information on an executive's annual taxable compensation from the company for up to five years and involves complicated adjustments to determine the amount attributable to equity compensation arrangements that vest in connection with a change in control. The difficulty of these calculations is demonstrated by the applicable employment agreement provisions, which typically provide for the tax gross-up amounts to be calculated by an accounting firm, contain provisions for addressing disputes over the calculation, and contain make-up/pay-back provisions in case the IRS contests the determination and asserts a different valuation for benefits subject to the tax provisions.

- The introductory paragraph reflects two substantive omissions from the circumstances that trigger disclosure under current Item 402(h)(2), both of which should be retained.

  - The phrase "following a change in control" was dropped from the current phrase "or a change in the named executive officer's responsibilities following a change in control." The purpose of proposed Item 402(k) is to elicit disclosure of "potential payments upon termination or change in control," not any payments that might be due to an executive any time his or her responsibilities change.

  - The $100,000 threshold in existing Item 402(h) should be retained (and increased to the $120,000 threshold proposed under Item 404) for disclosure under each category of triggering events (*e.g.*, under all "change-in-control" contexts, all "termination not for cause" contexts, etc.). While it may be rare when the amount of post-employment payments would be below this threshold, the situation is possible due to the variety of triggering events that would be covered by the proposed item, and the existence of a *de minimis* threshold will allow investors to focus on material payout events and will allow companies to avoid unnecessary effort and expense in preparing disclosures of immaterial information. In determining whether the threshold is exceeded, payments of pension and deferred compensation benefits that are disclosed elsewhere in the Item 402 tables should not be counted.

- Proposed clause (1) should be tightened to avoid voluminous, meaningless disclosure. The proposed language requiring companies to "explain the specific circumstances" that would trigger payments will result in voluminous disclosures that may obscure the presentations, because the words "explain" and "specific" suggest that a registrant must set forth and explain the specific contractual terms. As noted earlier, it is common for companies to employ a variety of definitions of "change in control," "cause" and even "retirement," and the specific definitions can often run for paragraphs and even pages. To promote concise, understandable disclosure, the clause should require companies to "briefly describe the terms and conditions," similar to existing Item 402(h).

- The first reference to the word "annual" in proposed clause (2) appears to be an error, since lump-sum payments are also encompassed by the clause. The clause would be clearer if revised to read:

  > "Describe and quantify the estimated payments and benefits that would be provided in each covered circumstance, disclosing whether they would or could be lump sum or annual and the estimated amounts in each case, the duration of such payments, and by whom they would be provided."

- The disclosure required by proposed Item 402(k)(3) is overly broad and ambiguous. For example, in the context of addressing a pension plan payment, "to describe and explain the specific factors used to determine the appropriate payment and benefit levels" could result in mere repetition of the pension payout formula and actuarial assumptions, and should be addressed in the same manner discussed above with respect to clause (1). If clause (3) is intended to address design and policy considerations, it should be moved to the CD&A requirements and should apply only to the year in which a material arrangement is first established or materially amended. Since severance and change-in-control agreements typically are standing arrangements, the information called for by clause (3) may be several years old and will already have been disclosed in prior year's proxy statements.

- The words "and explain" should be deleted from proposed Item 402(k)(4). Whether or not an executive is subject to a non-competition or similar obligation is typically included in disclosure under current Item 402(h). As with proposed explanations of the definitions of various triggering events, the terms of non-competition agreements are often complex and lengthy. We question the value of including this disclosure in the proxy statement when the underlying agreement will itself be a filed document.

VII. Technical Comments on the Item 402 Instructions

The Instruction to Item 402, which appears at the very end and has the surprising direction to include the fiscal year in the title of every table other than the SCT, should appear before Item 402(c) as a general Instruction for Items 402(c) through (l), so that it is not overlooked. In addition, a general Instruction should be added to Items 402(c) through (l), consistent with current interpretations, that inapplicable columns in any of the compensation tables may be omitted.

VIII. Determination of Named Executive Officers

We believe that the existing standard for determining the NEOs who are covered by Item 402 has operated effectively and that, subject to the change of specifying that PFOs will always be treated as NEOs, the existing standard should be retained. We concur that it is appropriate for PFOs to automatically be deemed NEOs due to their status as one of the executives who signs certifications with respect to companies' periodic disclosures, disclosure controls and internal controls over financial reporting.

We also concur with the Proposals' requirement to include the three additional executive officers who were the most highly compensated for the last fiscal year, and with continuing to include up to two former executive officers who would have been included in the SCT had they been executive officers at fiscal year end. This formulation has worked well to provide investors information on and insight into companies' executive compensation practices and has resulted in a manageable number of executive officers for whom the registrant has to calculate the details of every dollar of compensation. Likewise, applying the "executive officer" definition of Securities Act Rule 405, which encompasses certain designated officers of a registrant, officers in charge of a principal business unit, division or function and any other officer or person who performs a policy making function for the company, including persons employed by subsidiaries, has properly tied Item 402 disclosure obligations to those persons who are in a position to significantly impact the business and governance of companies.

The Commission should retain the existing standard of determining the additional NEOs based on the previous year's salary plus bonus. For 14 years this standard has effectively elicited disclosure on those executives who are provided the highest amounts of "take home pay" for the previous fiscal year, reflecting their role in managing a company's operations. In our experience, other benefits are often valued with reference to, or are graduated among executives on the same basis as, salary and bonus. We believe that the existing standard has operated well to identify those executives that are of the most interest to investors across literally thousands of companies with different compensation practices, and the instances under the existing standard where companies or stockholders have complained about anomalies in application of the standard have been fairly rare.

We strongly oppose the use of some or all of the other elements of compensation disclosed in the SCT for making the determination of which additional executive officers are NEOs. The inclusion of those other elements of compensation reflects a fundamental shift away from focusing on those executives who have been paid amounts based on actual performance for the prior fiscal year (or who have been paid large amounts of current compensation regardless of actual performance) and instead adds in elements of past wealth accumulation and future opportunities for compensation. This proposed shift would undermine the fundamental governance nexus in the designation of NEOs and instead would employ what appears to be an indiscriminate aggregation of different forms of compensation; the proposal shifts the disclosure regime from "who" and "what for" to simply "how much."

The proposed standard has a serious potential to distort the NEO determination and result in anomalous changes in NEO status from year to year. This is particularly true if the determination of NEO status is based on amounts proposed to be included in the All Other Compensation column. For example:

- Because the proposed deferred compensation earnings and pension plan accrual amounts are primarily measures of wealth accumulation that are influenced by tenure, past discretionary income deferrals and executives' individual investment decisions, using those amounts as a basis for determining NEO status will result in the exclusion of executives who may be receiving large salaries and bonuses based on their current contributions to and leadership of principal or policy-making functions; instead, executives whose current job responsibilities do not merit large salaries and bonuses may be included as a result of large retirement plan accruals arising merely from factors such as age or tenure.

- Because the All Other Compensation column includes post-employment payments received during a year, an executive who has never in her career been an NEO may appear in the SCT for the year in which she retires, simply because she elected a lump sum distribution of her deferred compensation or pension plan benefit.

- Including equity awards (whether options or restricted stock) in the determination of NEO status in the manner proposed (where the full fair value of an award is reported in the SCT in the year of grant instead of being allocated over the term of service) will result in frequent changes in the designation of NEOs at those companies where larger, longer-term vesting awards are granted (either in lieu of or in addition to annual equity awards), even though those awards represent only compensation opportunities and may never be earned.

Basing NEO status on a "total" calculation, especially when it includes all of the items that the Proposals include, would impose a significant burden on registrants. Today, under the current rules, registrants can relatively easily obtain the salary and bonus amount for the last fiscal year for each executive officer (and former executive officer) and determine who will be in the SCT for that year. Under the Proposals as drafted, however, a company would have to calculate every element of compensation, including those items in the Non-Equity Incentive Compensation and All Other Compensation columns that involve a large number of individual and often subjective assumptions, simply to determine who its NEOs are. We do not believe that this is a reasonable burden or cost to impose and, for the reasons noted above, question whether the changes it produces reflect better disclosure policy.

Finally, the Commission should note that its standard for determining NEOs affects the determination of which executive officers' compensation is subject to the limits on deductibility established under Code Section 162(m). Many companies' compensation committees take additional steps (which under the tax regulations generally must be in place by the end of the company's first quarter) to qualify various forms of compensation as "performance-based compensation" under Section 162(m), so that the compensation paid to executives will not be subject to Section 162(m)'s limitation on deductibility. While some companies seek to qualify compensation paid to all of their executive officers for purposes of Section 162(m), others implement arrangements each year that apply only to those executives who are expected to be the NEOs for the year. If the Commission changes the standard for determining who is an NEO retroactively (*i.e.,* so that it applies for the 2006 fiscal year), the tax planning by those companies could be undermined, with the result that they will cease to be able to deduct compensation paid to persons who become NEOs under the new standard but would not have been NEOs under the current salary-plus-bonus standard.

IX. Compensation of Directors

A. Approach in General

We concur with the general approach to director compensation taken by the Proposals, which would require formatted tabular disclosure, accompanied by narrative disclosure of additional material information, in both cases for the last fiscal year. We note that we previously supported tabular presentation of director compensation when the Commission previously proposed this approach in 1995.[66] We agree that a single table should suffice for director compensation and do not believe that additional tables (such as those proposed for NEOs) are necessary for investor understanding. We agree that standards and instructions applicable to corresponding columns for NEOs, including the means of valuing and threshold for disclosing perquisites, should apply to the Director Compensation table.

B. Suggested Changes to Tabular Disclosure

We suggest some refinements to the columns in the table to improve investors' understanding of director compensation.

1. Directors' Fees

With respect to column (c), which is titled "Fees earned or paid in cash", we suggest that the title be changed to "Directors' Fees" and that the description of what goes into that column be revised. Proposed Item 402(l)(2)(ii) currently states that this column should include "annual retainer fees, committee and/or chairmanship fees, and meeting fees." These are items that are appropriately called directors' fees, and we believe that investors will more readily understand the column if it is called "Directors' Fees." In addition, the language of the Item should be clarified to indicate that this column should include the identified items regardless of whether they are paid in cash or stock (in lieu of cash) and regardless of whether they are deferred at the election of the director or paid currently. We believe that this is consistent with the way that the Staff has interpreted the Salary column of the current SCT, and the amounts that go into the "Directors' Fees" column for directors are in our view analogous to salary for NEOs. Registrants should be permitted to indicate by footnote if any portion of the fees were paid in stock.

2. Stock Awards

Many investors are interested in the extent to which directors receive compensation in the form of stock rather than cash. In response to investor interest regarding stock awards, with the exception of stock that is paid *in lieu of* cash directors' fees (described above), we recommend that all stock purchased from or awarded to a director by the registrant or a subsidiary, whether purchased at a discount or not, be reported in the Stock Awards column. Under the Proposals, much of this information is to be disclosed in the All Other Compensation column. Proposed Item 402(l)(2)(vii)(D) states that the All Other Compensation column must include "any security of the registrant or its subsidiaries purchased from the registrant or its subsidiaries (through deferral of salary or bonus, or otherwise) at a discount from the market price." We believe that investors should not have to search for information about stock awards and purchases in a conglomerate of All Other Compensation.

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[66] *See* Securities Act Rel. No. 7184 (July 10, 1995) and the comment letter of the American Bar Association dated September 7, 1995 in File No. S7-14-95.

3. All Other Compensation

The instruction to this table should be revised to required disclosure of "All other compensation for service as a member of the board or committee thereof for the covered fiscal year ..." Investors and the Commission's audit committee member independence rule[67] distinguish between fees paid to a director in his or her capacity as a member of the board or a committee of the board, and other compensation. We do not believe that compensation paid for service other than as a director or member of a board committee should be included in the Director Compensation table. Instead, such amounts will be disclosed pursuant to Item 404 of Regulation S-K.

We also do not believe that amounts paid to fund director legacy or charitable gift programs should be included in the All Other Compensation column. Such amounts do not represent compensation paid to or received by a director, and disclosure of such amounts as director compensation could have the detrimental effect of causing companies to reduce or eliminate such programs in order to avoid having the amounts reported in the table mischaracterized as compensation paid to a director. Instead, we believe that such arrangements, including quantification of the cost to the company of such arrangements for each of the directors during the last fiscal year, should be reported in narrative text, perhaps under a special caption such as "Costs of Director Legacy and Charitable Gift Programs."

We do not understand what disclosure is intended to be provided in response to the proposed Instruction to Item 402(l)(2)(iv) and (v). The proposed Instruction requests footnote disclosure for columns reporting stock-based grants during the past fiscal year comparable to that "as would be required" for a proposed table that would report all of the NEO's holdings of equity awards. We believe that, consistent with the Commission's proposal not to require disclosure for directors with respect to information proposed to be presented for NEOs under Items 402(c) through (k), information should be provided only for equity grants reported in the Director Compensation table. Because this information is already called for as part of the narrative discussion accompanying the Director Compensation table pursuant to proposed Item 402(l)(3), the proposed Instruction should not be adopted.

4. Columns Similar to SCT Columns

A number of the columns proposed to be in the Director Compensation table are also in the SCT (Total, Stock Awards, Option Awards, Non-Stock Incentive Plan Compensation and All Other Compensation). With respect to each of such columns, we refer to the comments contained in Section II of this letter, which apply equally to the corresponding columns in the Director Compensation table.

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[67] *See* Exchange Act Rule 10A-3(B)(1)(ii).

C. Narrative Disclosure

As a practical matter, we believe that most of the textual disclosure necessary to understand the numbers in the Director Compensation table will be contained in footnotes tied to specific columns in the table. This approach achieves the laudable goal of tying the more detailed explanation of certain entries in the table to the actual entries themselves. However, we do not think that the Commission should prescribe exactly how much information must be in the footnotes versus in the narrative following the table. For example, if a registrant has a director option plan that provides for automatic grants annually to outside directors, it would be helpful to include a brief reference to the plan in a footnote tied to the Option Awards column and then to describe how the plan operates in the narrative following. To address this, the Commission should add an Instruction to Item 402(l)(3) to indicate that the narrative need not repeat information that is already included in footnotes to the table. We do not believe that there should be a CD&A covering director compensation. The explanatory narrative contemplated by the Proposals should provide the necessary information to be considered while viewing the disclosures in the table.

X. Proposed Revisions to Form 8-K

A. Revisions to Form 8-K Reporting on Compensation Matters Under Items 1.01 and 5.02

We agree that better balance is needed in the way that Form 8-K disclosure requirements apply to executive compensation events, as routine compensation actions have often triggered Form 8-K reports under current Item 1.01 and 1.02. Such reports disrupt internal personnel and human resource communication efforts while resulting in disclosures that do not meet traditional standards of materiality and that clearly do not satisfy the Form 8-K standard of being "unquestionably and presumptively material" events. The Proposals would provide that only material compensatory matters involving a PEO, PFO or NEO must be disclosed, applying traditional standards of materiality. We agree that the appropriate means to address this issue is to decouple Item 1.01 and Item 1.02 from the exhibit standard under Item 601(b)(10)(iii) of Regulation S-K through the wording set forth in the Proposal, and to address executive compensation matters exclusively through amendments to Item 5.02.

In implementing the foregoing revision, we believe the final rules should explicitly confirm two important aspects of this revision:

- The Instructions to Item 5.02 and/or the adopting release should expressly confirm that, as with other Items under Form 8-K, the standard of materiality is as defined by the case law. Correspondingly, the Instructions should affirmatively state that the presumption of materiality as to executive compensation agreements and arrangements contained in Item 601(b)(10)(iii) of Regulation S-K is not determinative for purposes of assessing materiality under the revised Item 5.02 disclosure requirements. While this point clearly underlies the proposed change, we are concerned that the absence of an express statement to such effect in the Instructions might undermine the objectives of the proposed amendment[68] if Item 601(b)(10)(iii) is applied by future practitioners or courts in interpreting amended Item 5.02.

- Instead of appearing in proposed Instruction 1 to Item 1.01, the new language would be more effective if set forth in the text of Item 1.01(b), to make clear that compensation arrangements are not to be covered by the general language of Item 1.01(b) and that Item 1.02(b) of Form 8-K – which cross-references Item 1.01(b) – also is not triggered by such matters. Under this approach, the last sentence of Instruction 1 to Item 1.01 would be deleted and Item 1.01(b) would be amended by adding at the end thereof, "except that an agreement involving the subject matter identified in Item 601(b)(10)(iii)(A) or (B) need not be disclosed under this Item."

Proposed Item 5.02(e) and Instruction 2 thereto seek to identify those types of compensation events not addressed by other parts of Item 5.02 that might be unquestionably and presumptively material events by:

(1) requiring a Form 8-K report for any material new or materially amended compensatory plan, contract or arrangement that covers PEOs, PFOs and NEOs, or any material grants or awards (or material amendments to grants or awards) to any such person under a plan, contract or arrangement; and

(2) excluding from the reporting requirement grants or awards pursuant to such a plan, contract or arrangement that are materially consistent with previously disclosed terms of the plan, contract or arrangement and that will be disclosed pursuant to Item 402 of Regulation S-K.

While the proposed language avoids the presumptive materiality standard arising from the current rule's reference to Item 601(b)(10)(iii) of Regulation S-K, it otherwise essentially codifies the Staff's interpretations on reporting grants and awards as set forth in Questions 8, 9, 11 and 12 of the Frequently Asked Questions for Current Reports on Form 8-K issued on November 23, 2004 (the "8-K FAQ"). We believe this aspect of the Proposals will not be effective in significantly reducing the number of Forms 8-K that report routine executive compensation events, due to ambiguities (and resulting disparate views and practices) over when incentive compensation programs constitute a "plan" or "arrangement," and due to the difficult qualitative materiality assessment that would be required under the Proposals to determine whether a specific grant or award is materially consistent with a previously disclosed plan, contract or arrangement.

[68] In the absence of an express statement to this effect, companies could become concerned that their determinations of materiality would be assessed in light of Item 601(b)(10)(iii) and consequently continue to file Forms 8-K reporting events that are of a routine matter.

We recommend that the Commission instead provide for disclosure in Forms 10-Q and 10-K of the matters addressed under proposed Item 5.02(e).[69] Item 601(b)(10)(iii) of Regulation S-K requires the compensatory plans, contracts, arrangements and form of grant or award agreements covered by proposed Item 5.02(e), and more, to be filed as exhibits with the Form 10-Q or Form 10-K for the quarter in which they are adopted or amended. We believe that investors and companies would both be better served if the information covered by proposed Item 5.02(e) were provided in those same filings, rather than on Form 8-K. Form 10-Q disclosure would provide more coherent information about compensation decisions on a consolidated basis, which would benefit investors by avoiding piecemeal Form 8-K disclosures and allowing companies greater opportunity to provide context to such disclosures. In addition, because the plans, contracts, arrangements, grants and awards covered by proposed Item 5.02(e) typically do not result in compensation payments to executives for at least a year, disclosure of these events to investors shortly after the quarter in which they occur would still provide investors with timely information as to the types of arrangements in place at a company. Form 10-Q disclosure would assist companies in rationally rolling out compensatory changes within their organizations by giving them more than four business days to communicate changes to affected employees and other internal constituencies.

Regardless of whether the Commission adopts our suggestion to provide for quarterly disclosure of the information called for under proposed Item 5.02(e), the language should be revised to clarify that disclosure is not required for the establishment of routine annual and long-term bonus or other arrangements that traditionally have been addressed in a company’s proxy statement. Instead, we believe the disclosure would more appropriately focus on events that are meaningful to investors if disclosure were triggered only when a company enters into, adopts, commences or otherwise materially modifies (1) a material written employment agreement with a PEO, PFO or NEO, or (2) a material plan, contract or arrangement (whether or not written) that covers the PEO, PFO or one of the NEOs and provides for compensation only in connection with a change in control, severance or other termination of employment.[70] We address only written employment agreements because oral agreements or understandings reflect only “at will” employment understandings that typically are not enforceable.[71] We believe that executives’ and

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[69] This could be implemented by placing the regulatory text in a new paragraph under Item 402 of Regulation S-K and amending Forms 10-Q and 10-K to require disclosure of the new Item.

[70] Plans, contracts or arrangements that provide compensation for continued employment would thus not be encompassed by this disclosure requirement, even if they also provided for vesting, acceleration or payment upon a change in control, severance or other termination. For example, a bonus plan that is tied to obtaining certain performance goals, but that also provides for payout at the target level if a change in control occurs during the performance period, would not be covered by the disclosure arrangement, but a plan that provides for a payment of two years salary upon a change in control would.

[71] For example, if an executive is promoted from a senior vice president to an executive vice president position, and it is generally understood that EVPs receive larger bonuses and option grants than SVPs, we do not believe that understanding constitutes an arrangement that should be subject to the proposed disclosure requirement.

companies' desire for ensuring the enforceability of true employment contracts safeguards against abuse of a "written employment agreement" standard. We do not believe that grants or awards under a previously disclosed plan, contract or arrangement ever justify Form 8-K "real time" disclosure, both because of the long-term nature of such grants and because all equity grants and awards to executive officers are already publicly disclosed under Section 16(a).[72] Likewise, we do not believe that either the adoption of a plan (or plan amendment) that is subject to stockholder approval, or stockholder approval of such a plan (or plan amendment), should be subject to Form 8-K. [73]

If the Commission codifies some of the language in the Instructions to proposed Item 5.02(e), either in the context of Item 402 of Regulation S-K for disclosures in Forms 10-Q and 10-K or in Item 5.02 for disclosures in Forms 8-K, we have the following technical comments:

- The references in proposed Instruction 2 to "original" terms may be confusing and would be clearer if it referred to "previously disclosed" terms.

- Instruction 2 should be revised to incorporate the guidance currently contained in Question 9 of the 8-K FAQ regarding information that can be omitted from a previous disclosure of a plan, contract or arrangement (and if the plan provides broad discretion as to the terms of its awards, each form of award or grant used under the plan for NEOs) without triggering disclosure of subsequent grants or awards that are consistent with the previously disclosed terms. Under Question 9, disclosures of the forms or terms of equity grants and awards can omit the identity of the recipient, the grant date, the number of securities covered by the award, the price(s) at which the recipient may acquire the securities, and the vesting schedule. Similar guidance should be provided with respect to cash plans (for example, the identity of the recipient, the target and maximum amount payable under an award, the vesting schedule and the performance criteria). We believe the current distinction that has emerged between the treatment of equity and cash plans is artificial, that the two types of plans should be treated similarly and that the general disclosure principle should be that information about specific awards made under a plan does not require Form 8-K disclosure if the awards are made on a basis that is substantially consistent with previous disclosures about the plan.

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[72] The Commission previously requested comment on requiring equity awards to be reported on Form 8-K and did not adopt that proposal when Section 16(b) was amended to require two day reporting. Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Rel. No. 46313, at note 15 (Aug. 6, 2002).

[73] Item 5.03(a) does not require a company to file a Form 8-K if an amendment to its certificate of incorporation or bylaws was set forth as a proposal in its proxy statement and approved by stockholders. Compensation plans that are subject to stockholder approval should not be treated any differently and therefore should not require a Form 8-K. If the Commission retains the requirement for stockholder approval of a plan or plan amendment to be reported on a Form 8-K, the reporting standard should be set forth in an Instruction to Form 8-K instead of in the 8-K FAQ.

B. Extension of Limited Safe Harbors under Form S-3 and Rules 13a-11 and 15d-11

If proposed Item 5.02(e) is not transferred to Form 10-Q, we agree that the safe harbors should cover proposed Item 5.02(e) since the Item will require the same type of difficult materiality assessments as the other Form 8-K items currently covered by the safe harbors.

In addition, other existing and proposed aspects of Item 5.02 have presented or will in practice present "traps for the unwary" in which the consequences of an untimely Form 8-K filing (*i.e.*, liability risks and loss of Form S-3 eligibility) disproportionately impact companies. These provisions include:

- The existing requirement under Item 5.02(b) to report a director's request not to be considered for re-nomination and election at the next annual meeting as a "refusal to stand for re-election." The Staff acknowledged in Question 24 of the 8-K FAQ that it is often difficult to determine whether this type of triggering event has occurred, due to the nuance that may exist in communications and uncertainty over "[w]hether communications represent discussion or consideration, on the one hand, or notice of a decision, on the other hand."

- The requirement under Instruction 2 to Item 5.02 as applied to Item 5.02(d)(3), requiring an amendment to a previously filed Form 8-K if a board-appointed director is during some unspecified period of time thereafter named to a board committee. Because changes in board committee service for other incumbent directors do not trigger disclosure in any other Commission filings,[74] it is not clear why appointment to a board committee in this situation is an "unquestionably and presumptively material" event requiring a Form 8-K amendment within four business days.

- The requirement under Instruction 2 to Item 5.02 as applied to Item 5.02(c)(3) as it is proposed to be amended, requiring an amendment to a previously filed Form 8-K if a newly named or promoted principal executive receives a grant or award under any plan, contract or arrangement "in connection with" the triggering event. It will be unclear whether a grant or award to a covered executive that occurs at the same time as grants or awards to other similarly positioned incumbent executives or that occurs months after the triggering event will be deemed to occur "in connection with" the triggering event or would be a routine compensation matter of the type addressed in proposed Item 5.02(e).

Rather than expanding the safe harbors to other sections of Item 5.02, we believe the trigger events in these Items should be clarified so that there is less subjective judgment and analysis

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[74] Proxy statements and Forms 10-K are required to identify the committees on which a director serves, but are not required to specifically call out changes in committee service. Companies typically provide current information on the directors' board committee service on their websites.

involved in determining whether a reportable event has occurred. With respect to the application of Item 5.02(b) to directors, the triggering event should be formal acceptance of the notice under a procedure established by the company's board of directors or nominating committee or, in the absence of such procedures, formal notice to the board chair. In addition, the Commission should state that a resignation that occurs pursuant to a "previously reported"[75] company policy[76] does not trigger a Form 8-K report. With respect to the other circumstances above, we recommend that Instruction 2 to Item 5.02 be amended to provide that the information called for by the enumerated paragraphs need be provided only if it has been formally decided by the appropriate decision-makers at the company and communicated to the executive or director at the time of the triggering event.[77] If an arrangement, grant or award has not been established and communicated to a covered executive at the time of the triggering event under Item 5.02(c), then it should be viewed as a routine, on-going compensation matter and the extent to which it is disclosed, if at all, should be governed by the disclosure standards under proposed Item 5.02(e), in whatever form that proposal is adopted. If a committee assignment has not been approved and communicated to a director at the time of a triggering event under Item 5.02(d), we do not believe that such information is of such material significance as to require a subsequent Form 8-K amendment.

If the Commission does not agree with the foregoing approach, we believe it would be appropriate to expand the safe harbors to cover some or all of the Item 5.02 reportable events. With respect to director departures under Item 5.02(b), judgment is often required to determine whether a triggering event has occurred. The safe harbor was enacted to protect companies in situations where judgment is required in order to determine if a triggering event has occurred, and accordingly it is appropriate to extend the safe harbor to cover these items. With respect to information called for under proposed Item 5.02(c)(3), rapid assessments of materiality will be called for and therefore, as with other Form 8-K Items requiring materiality assessments, the Item should be covered by the safe harbors. Finally, in light of the ancillary nature of the disclosures called for in Form 8-K amendments under Instruction 2 to Item 5.02, the safe harbors should cover those amendments.

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[75] General Instruction B.3. indicates that a Form 8-K need not be filed if substantially the same information required by the form has been "previously reported," as defined in Exchange Act Rule 12b-2. Many companies understand this instruction to cover director resignations that occur pursuant to a previously reported resignation policy, but in light of the uncertainty over the issue and the severe consequences with respect to Form S-3 eligibility status of failing to make an Item 5.02 filing, the Commission should confirm this aspect of the rules.

[76] As a matter of good corporate governance, companies often have corporate policies requiring a director to resign when they reach a previously disclosed retirement age.

[77] The Commission adopted a similar standard in the context of plans of termination under Item 2.05 of Form 8-K. Likewise, the Financial Accounting Standards Board adopted a similar standard under FAS 123R that is dependent on whether an arrangement has been communicated for determining whether an event constitutes a modification of an option. *See* FAS 123R, Paragraph B198: "The Board concluded that a modification of an award, regardless of whether that modification is in the form of a cancellation of an existing award and grant of a replacement award, would be explained as such to the employees affected by the transaction."

C. Identity of NEOs Under Items 5.02(b) and 5.02(e)

Because the definition of "named executive officer" is drafted to operate in what is typically a once-a-year application to determine who is covered by Item 402 of Regulation S-K, greater clarity is necessary to determine how the standard is applied for "real time" Form 8-K reporting throughout the year. We are concerned that the references to NEOs under proposed Items 5.02(b) and 5.02(e) of Form 8-K introduces uncertainty, both in the context of determinations that may be required after the end of a company's fiscal year but before it has prepared its proxy,[78] and because the reference to an NEO "for the registrant's most recent fiscal year" is confusing in the context of a term that is already defined with reference to specific time references.[79] We believe that the group of NEOs covered by Items 5.02(b) and 5.02(e) should be the persons identified in the company's most recent disclosure pursuant to Item 402(c) of Regulation S-K (*e.g.*, the last proxy statement, annual report or registration statement that contained a summary compensation table). This standard is simple to understand and implement and captures, throughout each year, the group of people whom we believe investors are most interested in knowing about.

D. Other Comments Relating to Proposed Amendments to Item 5.02

1. Reporting of Salary and Bonus Information Not Available at Time of Item 402 Disclosure

Proposed Instruction 3 to Item 5.02(e) should be codified as a separate item in Item 5.02 (for example, Item 5.02(f)) because it calls for disclosure (determining salary or bonus amounts for a completed fiscal year) that otherwise may not be required under proposed Item 5.02(e). We also suggest that the requirement be slightly reworded as follows:

> "(f) If, in accordance with Instruction 1 to Item 402(b)(2)(iv) and (v) of Regulation S-B or Instruction 1 to Item 402(c)(2)(iv) and (v) of Regulation S-K, information about the salary or bonus of a named executive officer was not included in the company's most recently filed Summary Compensation Table because such information was not known as of the latest practicable date prior to when the disclosure was provided, disclose the omitted information under this Item 5.02(f) when there is a payment, grant,

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[78] For example, assuming a calendar year registrant, it is generally believed that once S-K Item 402 information is filed in a proxy statement or Form 10-K, the NEOs identified therein will be NEOs covered by Items 5.02(b) and (e) for the remainder of the year after that filing. However, there is much less clarity on who are the NEOs between January 1 of the following year and the filing of new S-K Item 402 information in that subsequent year.

[79] The proposed text for Item 5.02 refers to "named executive officers for the registrant's most recent fiscal year," while the definition of "named executive officer" under proposed Item 402(a)(3) separately refers to executives who served "during [or "at the end of"] the last completed fiscal year."

> award, decision or other occurrence as a result of which such amounts become known."

Making this trigger event a separate item under Item 5.02 would also eliminate the need to affirmatively indicate in Instruction 3 that Instruction 2 does not apply to this requirement.

2. Proposed Revision of Item 5.02(c)

We agree with the proposed expansion of the scope of Item 5.02(c)(3) beyond employment agreements, subject to the comments above regarding interpretation of the "in connection with" standard, but suggest that the wording be clarified as follows (new language underlined):

> "(3) a brief description of (i) any material compensatory plan, contract or arrangement (whether or not written) to which a covered officer is a party or in which he or she participates that is entered into or materially amended in connection with the triggering event and (ii) any material grant or award, or any material modification of an outstanding grant or award, to a covered person that is entered into in connection with the triggering event."

3. Proposed Revision of Item 5.02(d)

Consistent with the proposal that removes changes in directors' compensation as a reportable event under Form 8-K, we do not believe that the disclosure of compensatory arrangements with new directors under proposed Item 5.02(d)(5) addresses information that will be viewed by investors as presumptively and unquestionably material. Moreover, unlike new principal officers, where the terms of employment arrangements tend to be highly negotiated and vary from one executive to another, new directors generally receive the same fees that will have been previously disclosed in the company's proxy statement or, in some cases, as an exhibit to a company's periodic reports. Accordingly, if the Commission determines to adopt proposed Item 5.02(d)(5), we believe the disclosure should be limited to compensatory arrangements that materially vary from the standard arrangements previously disclosed by the company. We note that disclosure of material contracts with directors that are not compensatory will be disclosed on Item 1.01 of Form 8-K pursuant to Item 601(b)(10)(ii)(A).

XI. Beneficial Ownership Disclosure

We generally support the proposal to require footnote disclosure for pledges of company stock. It is important that shareholders understand certain arrangements entered into by certain NEOs and directors that could materially affect the insider's economic position in company stock and we think it appropriate that such arrangements be disclosed in connection with the beneficial ownership table required under Item 403 of Regulation S-K. We believe that revised Item 403(b) should be amended to include "hedging" arrangements that materially affect the insider's economic position in the stock and to require disclosure only of arrangements that affect the insider's pecuniary interest in more than a *de minimis* number of shares. Under this approach, the new sentence added to Item 403(b) would read as follows:

> "Of the number of shares owned in column (3), indicate, by footnote or otherwise, as of the date beneficial ownership is reported (i) the amount of shares with respect to which such persons have the right to acquire beneficial ownership as specified in §240.13d-3(d)(1) of this chapter; and (ii) with respect to each named executive officer and to each director and director nominee, the amount of shares that are either (a) pledged as security or collateral, or (b) subject to an arrangement options, hedges, swaps, places a limit or floor or otherwise similarly results in the beneficial owner's economic interest in such shares being materially different than the interest he or she would have in the shares were they not subject to such arrangement; *provided however* that no disclosure need be made under (ii)(a) or (b) above in the event that: (1) the arrangement involves less than 25% of the shares set forth in column (3) in which the executive officer, director or director nominee otherwise holds a material direct or indirect pecuniary interest (as defined pursuant to Exchange Act Rule 16a-1(a)(2)), or (2) the arrangement is with the registrant and otherwise disclosed pursuant to Item 402, arises under community or marital property laws or nuptial agreements, consists of an assignment or transfer of an interest to an immediate family member or a bequest, or consists of a contract, instruction or plan to sell shares at market prices prevailing at the time of the sale.

Although one can debate whether a pledge of stock alters the pledgor's economic risk with respect to the pledged shares, particularly when the pledge is with recourse, we agree that material pledges should be disclosed because they reflect the fact that the beneficial owner has gained some liquidity from the stock in advance of an actual sale and otherwise can provide important information as to the NEO's, director's or director nominee's interest with respect to stock that is reported as beneficially owned by him or her.

Similarly, arrangements pursuant to which NEOs, directors and director nominees have contracted away down-side risk or upside potential of a significant amount of company stock also provide meaningful information to investors about the extent to which the insiders' interests as an equity holder of the registrant align with the investor's own interests. Such arrangements are typically structured as derivative transactions, such as collars, forward contracts and other instruments involving put and call options, and are sometimes referred to as "hedges." Just as with insiders' sales of company stock, which are closely monitored by some investors, many hedging transactions have the effect of reducing or eliminating the economic risk of continued ownership of the securities. Insiders entering into hedging transactions sometimes receive all the economic benefits of a "sale" of a security, while retaining the incidents of stock ownership (*e.g.*, the right to vote the shares). Thus, we believe that hedging arrangements of this sort should be disclosed through a footnote to the security ownership table if the arrangement materially affects the ownership information reflected in the table.[80]

We believe that the disclosure requirement for hedging arrangements should be broad enough to pick up the variety of sophisticated financial instruments offered by brokers and banks that allow the insider to hedge financial risk in stock, but should expressly exclude certain arrangements that either are disclosed elsewhere (including conditions imposed on securities through registrant compensation arrangements), reflect family and estate planning arrangements or that do not materially alter the insider's financial interest in company stock that he or she beneficially owns. The latter would include contracts, instructions and plans that are established to comply with Rule 10b5-1(c) and that provide for transactions at prevailing market prices. This reflects the fact that such Rule 10b5-1(c) arrangements do not affect the insider's economic position with respect to the stock because the insider continues to bear full market risk on the shares until such time as they are sold.

Because the intent is to indicate arrangements where the individual has altered his or her economic interest in the securities that he or she beneficially owns, it is axiomatic that the disclosure should apply only to securities in which the individual has a material direct or indirect pecuniary interest (with "pecuniary interest" defined pursuant to Exchange Act Rule 16a-1(a)(2)). "Beneficial ownership" for purposes of Item 403 is based on voting or investment control, and thus may encompass securities in which the individual does not have any economic interest or has only an indirect and immaterial economic interest, such as shares held by a venture capital or investment fund in which the individual is a managing general partner or shares held by an employee benefit plan trust over which the individual is a trustee. Given the difficulty that may be involved in assessing and disclosing the implications of such arrangements, we believe that disclosure should be required only if the arrangements affect a significant amount (more than 25%) of the securities in which an NEO, director or director nominee has a material direct or indirect pecuniary interest. If a covered individual has a pledge arrangement that includes other collateral (such as other companies' securities) and has instructed the pledgee to liquidate those other securities first if the pledge is foreclosed on, that instruction should be recognized in calculating the extent to which the individual's shares are pledged. Similarly, if an individual has entered into a hedge arrangement under which the number of securities covered fluctuates, the number of shares disclosed as being subject to the arrangement should be based upon an estimate of the number of shares covered as if the arrangement settled on the date that beneficial ownership is calculated. Finally, we believe that the disclosure obligation should not be required for "all executive officers, directors and director nominees as a group," as such information will be difficult to assimilate and unlikely to provide additional meaningful information to investors.

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[80] Certain hedging arrangements involve a pledge of the underlying shares of issuer stock subject to the hedge. To the extent that Item 403(b) requires disclosure only of pledge arrangements, without requiring disclosure of the background transaction in which the pledge occurs, disclosure regarding the pledge alone may not provide investors with a complete picture of the insider's interests in issuer stock.

XII. Treatment of Foreign Private Issuers

A number of provisions of the Proposing Release request comment with respect to proposed changes relating specifically to foreign private issuers.

A. Proposed Amendment to Item 402 of Regulation S-K

The Proposing Release indicates that a foreign private issuer is currently deemed to comply with Item 402 of Regulation S-K if it provides the information required by Items 6.B and 6.E.2 of Form 20-F, with individual compensation information provided only if it is required in the company's home country or otherwise made publicly available.[81] The Proposals would continue this treatment of foreign private issuers and include a conforming clarification by amendment to Item 402.[82] Subject to the comments set forth below and in Part XII.D. of this letter, we agree that foreign private issuers filing on Form 20-F should be deemed to be in compliance with Item 402 of Regulation S-K. We strongly believe that no additional disclosure should be mandated beyond the scope of what is currently required. As we understand, the proposed amendment to Item 402 would obligate every foreign private issuer to undertake a review of each of the many Item 402 disclosure components, and then to determine whether the information disclosed or required to be disclosed by such issuer under its home jurisdiction or securities exchange requirements would fall within any of the Item 402 categories. In view of the extensive analysis and disclosures that would be required pursuant to Item 402, this would impose a considerable and unnecessary burden on foreign private issuers. Effectively under the Proposals, foreign private issuers would be required to undertake an Item 402 review equivalent to that undertaken by domestic issuers. Even if an issuer were to determine that it is obligated to provide certain information in its Form 20-F, it may be unclear how such information should be set forth in the context of the various presentation requirements of Item 402. By reason of the provisions of Rule 408 under the Securities Act and Rule 12b-20 under the Exchange Act requiring that all material information be set forth in a document filed with the Commission, the imposition on foreign private issuers of an obligation to furnish any such additional detailed information would, in our view, be unnecessary. We are also of the view that any requirements for more detailed disclosure would serve as a disincentive to the willingness of foreign private issuers to enter, or remain in, the U.S. securities markets. We therefore strongly urge the Commission not to adopt any more burdensome requirements.

We question the need to make any reference to foreign private issuers in Item 402 of Regulation S-K. Form 20-F is self-contained, unless a specific item of Form 20-F refers to an extrinsic requirement.[83] The addition of a specific exclusion relating to foreign private issuers in Item 402

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[81] *See* Section II.C.2. of the Proposing Release.

[82] *See* proposed Item 402(a)(1) of Regulation S-K.

[83] Form 20-F does not contain any reference to Item 402.

may give rise to questions regarding the applicability of other Regulation S-K items in the absence of specific exception language. Further, the implication of the proposed amendment to Item 402 is that any failure by a foreign private issuer to comply fully with Items 6.B and 6.E.2 of Form 20-F may subject the issuer to full Item 402 disclosure. We strongly oppose this conclusion. Should the Commission believe that some reference to foreign private issuers is appropriate in Regulation S-K, we believe it would be preferable for Regulation S-K to set forth a general statement that the provisions of Regulation S-K are not applicable to any foreign private issuer filing registration statements or annual reports on Form 20-F under the Securities Act or Exchange Act, respectively, unless specifically otherwise provided in Form 20-F.

As a further matter, we do not believe that proposed Item 402 should refer to Item 6.E.2 of Form 20-F. Item 6.E.2 deals generally with arrangements for involving the employees in the capital of the company, including any arrangement that involves the issue or grant of options or shares or securities of the company.[84] Because this Item does not relate specifically to executive compensation, we believe that reference to such Item in the Proposals is unnecessary. Moreover, as stated above, we strongly oppose any suggestion that a failure to fully comply with Item 6.E.2 subjects a foreign private issuer to full Item 402 disclosure.

The Proposing Release also asks whether a foreign private issuer that is required to comply with Item 402 (for example, by filing an annual report on Form 10-K) should be required to provide all of the information required under Item 402 instead of the information required under Form 20-F. Because we believe that most foreign private issuers electing to file using domestic forms do so pursuant to debt covenants primarily for the purpose of providing quarterly financial information, we believe that relief from Item 402 for such foreign private issuers would be welcome.[85]

B. Proposed Amendment to the Exhibit Instructions of Form 20-F

The Proposing Release proposes to amend the exhibit Instructions to Form 20-F to eliminate an inconsistency between the executive compensation disclosure obligations of Form 20-F and the

[84] The scope of Item 6.E.2 is extremely broad. Unlike Item 6.E.1, this Item is not limited to the persons listed in subsection 6.B. Moreover, the instruction to Item 6.E that permits exclusion of certain information relates to share ownership, and not to compensation. That instruction provides that if any of the persons listed in subsection 6.B beneficially owns less than one percent of the class of shares and that person's individual share ownership previously has not been disclosed to shareholders or otherwise made public, the company may indicate, by an asterisk and explanatory footnote or similar means, that the person beneficially owns less than one percent of the class, instead of providing that person's individual share ownership.

[85] A number of foreign issuers file annual reports on Form 10-K because they do not satisfy the foreign private issuer criteria set forth in Rule 3b-4(c) under the Exchange Act. The proposed amendment of Item 402 would not apply to such issuers. Such issuers will continue to be required to furnish the same information required to be provided by domestic issuers.

exhibit requirements.[86] Under the existing rules, an issuer that provides any individualized compensation disclosure is required to file as an exhibit to the Form 20-F management employment agreements that potentially relate to matters that have not otherwise been disclosed.[87] Subject to the comments set forth in XII.D. below, we support the proposed amendment to the exhibit Instructions to clarify that the exhibit need not be included if the public filing of the management contract or compensatory plan, contract or arrangement, or portion thereof, is not required in the company's home country and is not otherwise publicly disclosed by the company. We believe that the current requirement to file any such document is viewed by many foreign private issuers as unnecessarily intrusive, and implicates sensitive privacy considerations. We share the view of the Commission that the elimination of these privacy concerns may encourage foreign private issuers to provide more compensation disclosure in their Commission filings. We also agree that the proposed revisions would recognize the international trend toward greater compensation disclosure and provide for greater harmonization of international disclosure standards in a manner consistent with the requirement of Form 20-F.

C. Proposed Amendment to Item 404 of Regulation S-K

As indicated in the Proposing Release, a foreign private issuer is currently deemed to comply with Item 404 of Regulation S-K if it provides the information required by Item 7.B of Form 20-F.[88] The Proposals would continue this treatment but would provide that, if more detailed information is required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded, the same information must also be disclosed pursuant to Item 404.[89] Subject to the comments set forth below and in XII.D. of this letter, we agree that compliance with Item 7.B of Form 20-F should be deemed to constitute compliance with Item 404 of Regulation S-K. We believe, however, that additional detailed information should not be required to be disclosed pursuant to Item 404. Currently, foreign private issuers preparing reports or registration statements on Form 20-F are only required to comply with Item 7.B regarding the disclosure of related party transactions. The proposed amendment to Item 404 would require each foreign private issuer to also undertake a review of each of the Item 404 disclosure components, and then to determine whether the information disclosed or required to be disclosed by such issuer under its home jurisdiction or securities exchange requirements would fall within any of the Item 404 categories. We believe this to be an unnecessary burden. By reason of the provisions of Rule 408 under the Securities Act and Rule 12b-20 under the Exchange Act requiring that all material information be set forth in a document filed with the Commission, the imposition on foreign private issuers of an obligation to furnish any such additional detailed information would, in our view, be unnecessary. We are also of the view that any requirements

[86] *See* Section III.D. of the Proposing Release.

[87] The amendment would revise Instruction 4.(c)(v) of the Instructions as to Exhibits.

[88] *See* Section 5.E.2. of the Proposing Release.

[89] *See* proposed Instruction 2 to Item 404 of Regulation S-K.

for more detailed disclosure would serve as a disincentive to the willingness of foreign private issuers to enter, or remain in, the U.S. securities markets. We, therefore, strongly urge the Commission not to adopt any more burdensome requirements.

The Proposing Release also asks whether a foreign private issuer that is required to comply with Item 404 (for example, by filing an annual report on Form 10-K) should be required to provide all of the information required under Item 404 instead of the information required under Form 20-F. Because we believe that most foreign private issuers electing to file using domestic forms do so pursuant to debt covenants primarily for the purpose of providing quarterly financial information, we believe that Item 404 accommodation for such foreign private issuers would be welcome. Consistent with our comment relating to Item 402 above, we believe it would be preferable for Regulation S-K to set forth a general statement that the provisions of Regulation S-K are not applicable to any foreign private issuer filing registration statements or annual reports on Form 20-F under the Securities Act or Exchange Act, respectively, unless specifically otherwise provided in Form 20-F.

D. General Comments

Under the existing rules of the Commission, many of the U.S. reporting or filing obligations of foreign private issuers are derivative of the obligations of such issuers in their home jurisdictions or under the rules of securities exchanges on which their securities are listed or traded. We believe such accommodations are, in general, desirable and avoid situations where U.S. disclosure obligations are deemed to drive the public disclosure obligations of foreign private issuers. In the context of the existing rules and the proposed rules, we have several suggestions that we believe would further the expressed intention of the Commission to achieve greater harmonization.

1. Conform the Standards Relating to Disclosure

Under the proposed rules, differing standards would appear to apply to the disclosure requirements to which foreign private issuers would be subject. Although, as discussed above, we strongly urge the Commission not to adopt any more burdensome requirements applicable to foreign private issuers, should the Commission determine to require additional detailed information, the standards relating to such disclosure should be harmonized:

- Under the proposed amendment to Item 402(a)(1) of Regulation S-K and to Instruction 2 to Item 404 of Regulation S-K, more detailed information would be required “if otherwise made publicly available or required to be disclosed by the issuer’s home jurisdiction or a market in which its securities are listed or traded.”

- The specific language of the proposed amendment to Instruction 4(c)(v) of Instructions as to Exhibits, Form 20-F, is not set forth in the Proposing Release. According to the Proposing Release, the exhibit requirement would be tied to the disclosure requirements with respect to executive compensation. Item 6.B.1. of Form 20-F requires

> individualized compensation disclosure unless individualized disclosure is not required in the company's home country and is not otherwise publicly disclosed by the company.

We believe that different formulations regarding information required to be disclosed may lead to confusion. For example, the proposed amendments to Items 402 or 404 do not clearly state that, in order to be included in these items, the public disclosure of the relevant information must originate with the company. Under the proposed language, it would therefore be possible for disclosure obligations to arise as a result of unauthorized public dissemination of information, or disclosure of information by an entity other than the company. The proposed amendment to the exhibit requirements makes clear that the information must originate from the company, and we believe that any comparable provisions the Commission may determine to include in Item 402 and 404 should so provide as well.[90]

2. Clarify the Meaning of "Publicly Available" or "Publicly Disclosed"

Because the Commission has determined that disclosure of executive compensation and related party transactions involving foreign private issuers need not be more extensive than the information publicly disclosed outside the United States, we believe the Commission should also reflect in its rules and forms (including the provisions regarding individualized compensation disclosure in current Section 6.B of Form 20-F) a sensitivity to the manner in which information is disclosed. We believe that references to information that is made publicly available by foreign private issuers should exclude information that is not widely disseminated to security holders. For example, we do not believe that information should be deemed to be publicly available if it is only available, upon request, for inspection at the head office of a foreign private issuer, or is available only in connection with an on-site review of the files of a foreign securities exchange. In our view, if the home jurisdiction or foreign securities exchange does not require widespread public dissemination of such information, we see no reason for the Commission to do so.[91] Instead, we believe that the Commission's purposes can be served by requiring a foreign issuer to indicate in its Form 20-F the same information regarding public availability of this information as the issuer is required to disclose under its home country or foreign securities exchange obligations.[92]

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[90] Similarly, information required to be disclosed on Form 6-K is limited to information disclosed by the issuer. This distinction would not be necessary if the Commission were to adopt the overall exemption from Item 402 and 404 obligations suggested in this letter for foreign private issuers using Form 20-F.

[91] Substantially all documents filed by foreign private issuers subject to Exchange Act reporting are available through the EDGAR system.

[92] We believe this interpretation of publicly available information should also extend to the requirements of Form 6-K.

XIII. Treatment of Small Business Issuers

The Proposals make a number of accommodations for "small business issuers" ("SBIs") with respect to the executive compensation disclosures that are required.[93]

We strongly support the Commission's proposed accommodations for SBIs that are reflected in the Proposals. We note that all of our comments in this letter on the Regulation S-K executive compensation disclosure requirements apply equally with respect to their corresponding Regulation S-B requirements for SBIs. In addition, we believe that the SCT for SBIs should not include values attributable to defined contribution plan earnings and pension plan accruals, as the Commission has not proposed that SBIs be required to calculate those values for purposes of the Retirement Plan Potential Annual Payments and Benefits Table and Non-Qualified Defined Contribution and Other Deferred Compensation Plans Table. The benefit of relieving SBIs from calculating benefits under such arrangements will be undermined if the companies must nonetheless calculate and report similar amounts in the SCT's "All Other Compensation" column. Moreover, we point out that it is especially important that the determination of NEO status for SBIs be made based on salary plus bonus, as required by the current rules, and not based on total compensation (or any other subset of SCT columns). The burdens of having to calculate total compensation for each executive officer just to determine NEO status could be particularly acute. Whether or not the Commission accepts our suggestion that NEOs be determined based on salary plus bonus under Item 402 of Regulation S-K, it is critical that such determination by SBIs be based on salary plus bonus. Any other subset of the items required to be disclosed in the SCT would hopelessly overburden the already stretched capabilities of SBIs. We further note that,

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[93] Proposing Release at II.C.1. SBIs would be required to provide the following information under proposed Regulation S-B:

- Summary Compensation Table (two fiscal years) *(Item 402(b))*
- Outstanding Equity Awards at Fiscal Year-End Table *(Item 402(d))*
- Director Compensation Table *(Item 402(f))*
- Narrative discussion of the SCT, post-employment compensation and director compensation *(Items 402(c), (e) and (f)(3))*
- Identification of specific perquisites or other elements contained in the "All Other Compensation" column of the SCT that exceed the greater of $25,000 or 10% of all items in the column *(Item 402(c)(1)(vii))*
- NEOs are the current (and former, if applicable) PEO plus the two most highly compensated executive officers based on total compensation (and up to two former executive officers) *(Item 402(a)(2))*

Under the Proposals, SBIs are <u>not</u> required to provide:

- The third fiscal year of information in the SCT
- Supplemental Tables to the SCT (Grants of Performance-Based Awards Table and Grants of All Other Equity Awards Table)
- Option Exercises and Stock Vested Table
- Post-Employment Compensation Tables (Retirement Plan Potential Annual Payments and Benefits Table and Non-Qualified Defined Contribution and Other Deferred Compensation Plans Table)
- Compensation Discussion and Analysis
- Compensation Committee Interlocks and Insider Participation in Compensation Decisions

similarly, SBIs should not be required to determine whether there are any non-executive officers whose compensation would require disclosure under proposed Item 402(c)(2) of Regulation S-B.

Finally, we encourage the Commission to apply the expanded definition of "smaller public companies" proposed by the Commission's Advisory Committee on Smaller Public Companies in its final report to the Commission[94] for purposes of determining the disclosures required under Item 402 of Regulation S-B.

XIV. Transition Issues

A. Inconsistent Reporting Rules

Companies should not be required to report compensation information for the same year under both the old and new rules. Under the proposed phase-in dates, some companies might find themselves in the position where their Form 10-K is subject to the old rules, while a subsequent filing made later during the same year is subject to the new rules. We do not think this is a desirable outcome from the perspective of registrants (due to the additional work involved in complying with the two different sets of disclosure requirements) or for investors (due to confusion that might result from the inconsistent disclosures). Following is a discussion of two areas where we believe this issue may arise.

1. Form 10-K and Annual Meeting Proxy Statement

Under the Proposal, the new disclosure rules would apply:

- to Forms 10-K for fiscal years ending 60 days or more after publication; and
- to proxy statements filed 90 days or more after publication.

For companies that follow the typical pattern of completing their annual meeting proxy materials within 120 days after fiscal year end (which corresponds to the maximum time allowed to rely on forward incorporation by reference of the proxy statement into the Form 10-K), the proposed transition rule could require disclosures in the Form 10-K that differ from those required in the proxy statement. For example, if the new rules are published September 15, 2006, a company with an October 31, 2006 year end:

- would not be required to comply with the new rules in its Form 10-K because September 15, 2006 (the publication date) is less than 60 days prior to the company's year-end; but
- would be required to comply with the new rules in its proxy statement if the company follows the usual pattern of finalizing its proxy statement in January 2007 (because that is more than 90 days after publication).

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[94] Available at http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf .

We do not think this result is appropriate. Instead, the content of the annual meeting proxy statement (and any other proxy or information statements filed during the same year) should be determined by what is required to be included in the Form 10-K.

2. Follow-On Offerings

As proposed, an already public company that is registering a follow-on offering on Form S-1 might be required to comply with the new rules even though it was not originally required to do so in its most recent Form 10-K. We do not think this is an appropriate result. Instead, the proposed effectiveness date for follow-on Securities Act registration statement filings should be revised so that the disclosure required in the follow-on offering corresponds to the disclosure that the company was required to provide in its Form 10-K. We note that this relief would not need to be extended to registration statements on Form S-1 relating to IPOs by companies that are not already reporting companies or to registration statements on Forms S-3 and S-8 (since those forms contemplate incorporation by reference of the Form 10-K and do not themselves require direct disclosure of compensation information). A similar issue does, however, need to be addressed for registration statements on Form S-4 filed by companies that provide Form S-1 level disclosure.

B. Initial Application of New Rules to Calendar Year-End Companies

The transition to the new rules will inevitably result in significant extra work during the initial year of implementation as companies and their advisors seek to understand and implement the new requirements. In order to maximize the amount of time available after the new rules are finalized and to spread the cost of coming up the learning curve as broadly as possible, we believe it would be appropriate for the new rules to initially apply to companies having a fiscal year that ends on or after December 15, 2006, which includes a large number of calendar year-end companies, instead of to the smaller number of companies that have fiscal years ending prior to December 15, 2006.

C. Scope of Required Information During the First Year the New Rules Apply

We believe that (1) certain of the new proposed disclosure requirements should apply only with respect to fiscal years <u>beginning</u> 60 days or more after the publication date, (2) the new rules should not require companies to recreate any information with respect to years for which they were previously required to apply the current rules and (3) some form of automatic relief should be available during the first year that the new rules apply with respect to information not previously required under the current rules that a company cannot provide without undue expense or effort.

1. Disclosure of Certain Newly Required Information Should Be Prospective Only

With respect to certain of the new disclosures that would be required by the proposed rules, we believe companies should be given time to put in place policies, procedures and controls that conform to the new disclosure requirements and to establish systems that will correctly capture the newly required information.

Specifically:

- For the reasons discussed in VIII above, if a company relied upon the existing definition of NEO for purposes of establishing compensation arrangements that are exempt from the limitations of Code Section 162(m) and adoption of a new definition of NEO would result in a change in who qualifies as an NEO and cause compensation to the newly designated NEO to not be deductible under Section 162(m), the company should have the ability to elect for the transition year only to apply the existing standards for determination of its NEOs.

- If the requirement to disclose non-executive officers' compensation is adopted (which as discussed above in Section II.E. we do not support), the requirement should apply prospectively only, as companies have not previously been required to track for potential disclosure purposes compensation information about employees who are not executive officers.

- Once the proposed disclosure rules regarding policies and procedures for the review and approval of related party transactions are finalized, companies should be provided with an opportunity to conform their existing polices and procedures to the new disclosure requirements. We do not think it is appropriate to require companies to make retroactive disclosures under the new rules in their 2007 proxy materials regarding their policies and procedures for handling related party transactions that occurred during 2006.

2. Companies Should Not Be Required to Recreate Information for Prior Years

In the proposing release, the Commission acknowledges that companies should not be required to "restate" compensation or related party disclosure for fiscal years for which they were previously required to apply the current rules. In addition to the SCT and related party transaction contexts that are discussed in the Proposing Release, similar issues arise in other contexts. These include the Option Exercises and Stock Vested table, where companies should not be required to go back and calculate grant date fair values for options granted before FAS 123R was mandatory, and the Nonqualified Defined Contribution and Other Deferred Compensation Plans table, where companies should not be required to separately quantify contributions and earnings from periods before adoption of the rules. We believe the transition section of the adopting release or the Instructions to the rules themselves should include a blanket exclusion from any requirement to provide information regarding fiscal years for which companies were previously required to apply the current rules or, in the case of new registrants, fiscal years prior to when they became reporting companies.[95]

We also wish to confirm our understanding of how the phase-in of the new SCT will be implemented. The following example illustrates our understanding of how the phase-in would work in the case of a calendar year-end filer. Assuming the new rules are published more than 60 days prior to December 31, 2006, a calendar-year end filer would include in its Form 10-K and its proxy statement:

- For the year ending December 31, 2006: The new SCT with information for 2006. Interested stockholders would obtain compensation information for 2005 and 2004 by referring back to the prior year's Form 10-K/proxy statement.

- For the year ending December 31, 2007: The new SCT with information for 2006 and 2007.

- For the year ending December 31, 2008: The new SCT with information for 2006, 2007 and 2008.

3. Companies Should Be Extended Some Relief in the First Year the New Rules Apply

If, during 2007, a company is unable to provide any required information with respect to 2006 compensation and such information was not expressly required under the current rules, we believe the company should be allowed to omit that information and still be considered to have a timely and complete filing if the company discloses in the filing itself what information is being omitted and the reason for the omission. We believe the automatic availability of such relief during the transition year strikes a proper balance between the burden on companies of having to comply with the new rules with respect to a year that will be largely completed by the time new rules are adopted and the desire of investors to have the new rules apply to disclosures made in the 2007 proxy statements regarding 2006 compensation. The requirement to affirmatively disclose and explain the omission will keep companies from abusing this limited exception. Importantly, this limited exception will protect companies, and ultimately their stockholders, from being penalized (*e.g.*, by potentially facing a loss of Form S-3 eligibility or WKSI status) for the fact that the company did not track a piece of information that was not previously

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[95] We also believe it would be appropriate in the context of new registrants for the Commission to (1) permit new registrants to address CD&A and governance disclosures on a prospective basis only (*i.e.*, describing policies and procedures that the company intends to follow once it becomes a public company) and/or (2) acknowledge that the CD&A and governance disclosures provided by new companies may in many cases be much briefer than the disclosure provided by established public companies as a result of the reduced formality and absence of independence requirements applicable to private companies.

required to be disclosed and that turned out to be more difficult to generate than was expected at the time the new rules were adopted.

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The Committee appreciates the opportunity to comment on the Proposals and respectfully requests that the Commission consider the recommendations set forth above. We are prepared to meet and discuss these matters with the Commission and the Staff and to respond to any questions.

Respectfully submitted,

/s/ Dixie Johnson

Dixie Johnson
Chair, Committee on Federal Regulation of Securities

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