THE ROCK CENTER
FOR CORPORATE GOVERNANCE

STANFORD UNIVERSITY

Executive Compensation Disclosure:
An Analysis of the SEC's Proposed New Rules

April 3, 2006 Washington, DC

Transcript of Proceedings

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April 3, 2006
9:30 a.m. – 3:30 p.m.
The Columbus Club, Union Station, Washington, DC

AGENDA

9:30 a.m. Registration

10:00 a.m. **Introduction and Welcome** by the Honorable Christopher Cox, Chairman of the SEC and Joseph A. Grundfest, William A. Franke Professor of Law and Business, Stanford Law School

10:15 a.m. **Conceptual Issues Motivating the Disclosure of Executive Compensation**

Moderator: Robert M. Daines, Pritzker Professor of Law and Business, Stanford Law School

Panel:
Alan Beller, Director of the Division of Corporation Finance (2002-2006), SEC
Kevin Murphy, Kenneth L. Trefftzs Chair in Finance and Vice Dean of Faculty and Academic Affairs, USC Marshall School of Business
David Yermack, Associate Professor of Finance, Stern School of Business, NYU
Jamie Heard, Vice Chairman, Institutional Shareholder Services

11:15 a.m. **Disclosure of Compensation on the Assumption that Executives Remain Employed**

Moderator: David F. Larcker, Professor of Accounting, Stanford Graduate School of Business

Panel:
John Core, Associate Professor of Accounting, The Wharton School, University of Pennsylvania
Brian Foley, Brian Foley & Company, Inc.
Katherine Schipper, Board Member, FASB

12:15 p.m. **BREAK**

12:30 p.m. LUNCH: Remarks by John White, Director of the Division of Corporation Finance, SEC

1:30 p.m. **Disclosure of Compensation Triggered by Retirement, Dismissal or Change in Control**

Moderator: Dan Siciliano, Executive Director, Stanford Law School Program in Law, Economics & Business

Panel:
Adam Chinn, Partner, Wachtell, Lipton, Rosen and Katz
Tom Kelly, Compensation Practice Leader, Watson Wyatt Worldwide
Gregory P. Taxin, CEO, Glass Lewis & Co. LLP

2:30 p.m.	**Director Compensation and the Boardroom Response to Compensation Disclosure**
	Moderator: Joseph A. Grundfest, William A. Franke Professor of Law & Business, Stanford Law School
	Panel: Joseph Bachelder, Bachelder Law Firm Matthew Bishop, Chief Business Writer, The Economist Simon M. Lorne, Vice Chairman, Millennium Partners, LP and former General Counsel of the SEC (1993-1996)
3:30 p.m.	**ADJOURNMENT**

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[Begin Recorded Material.]

Joe Grundfest: Welcome to the inaugural Rock Center conference on matters related to corporate governance. The focus of today's session is the Securities and Exchange Commission's proposed new rules regarding disclosure of executive compensation, and we hope that this conference will be the first of many sessions of this sort that we'd be doing all over the country. The Rock Center for Corporate Governance was founded with an extraordinarily generous gift from Mr. Arthur Rock. Arthur is one of the earliest venture capitalist in the United States. Arthur has had six huge successes in the venture capital business. He's helped start little companies you may have heard of like Apple Computer. You know Intel inside? Arthur helped found Intel, National Semiconductor, and many other companies of that ilk. Arthur has had roughly six remarkable successes along those lines, and believes very strongly that corporate governance can be a power for good, and can be a power for creativity. In his personal experience he believes he's

been successful because he's worked with organizations where there has been good corporate governance, and he'd like to help figure out how to improve corporate governance throughout the economy. It's for that reason he's helped found the Rock Center at Stanford.

What we hope to do with conferences of this sort, very simply, is to address an interesting issue in terms of the public comment process that arises whenever a regulatory agency issues a rule for comment that implicates the corporate governance process. The tradition in Washington, and it's something that I'm sure most of you are familiar with, is that the request for comments goes out, and most of the heavy lifting is done, quite rationally, by organizations that have a vested interest in the rules that are going to be adopted by the regulatory agency. There is often relatively little deep and reasoned input from the academic community and other constituencies that may have tremendous interest and expertise in the rule, but simply aren't wired into the process of commenting on the rules that are issued for comment. Among the initiatives we are launching at the Rock Center is a series of academic conferences that will address proposed rulemakings that implicate the governance process. Whenever there's a proposal that implicates corporate governance concerns, we plan to quickly bring together some of the leading experts in that field, so they can confer in a public environment, share their observations regarding the proposed rule, and very importantly, communicate with the regulators who are actually going to be writing those rules.

One of the big reasons why we're here today is not merely to have academics talk to each other. Lord knows we do plenty of that. Our purpose is also not just to answer questions that might be posed from members of the press and others in the audience. We also hope to promote a stimulating dialogue with the people who have direct responsibility for writing the rules that are going to be adopted, and thereby creating a new avenue for public comment as part of the regulatory process. And with that by the way of introduction I'd like to take a moment to introduce my very good friend Chris Cox, who is the new chairman of the United States Securities and Exchange Commission and who, I think, has gotten off to one of the most positive and remarkable starts as a new chairman of the SEC in the history of the agency. With that ladies and gentlemen I give you the Honorable Chris Cox.

THE TEXT OF REMARKS BY CHAIRMAN COX CAN BE FOUND AT http://www.sec.gov/news/speech/2006/spch040306cc.htm

Panel 1: Conceptual Issues Motivating the Disclosure of Executive Compensation

Moderator: Robert M. Daines, Pritzker Professor of Law and Business, Stanford Law School

Panel:

1.Alan Beller, Director of the Division of Corporation Finance (2002-2006), SEC
2. Kevin Murphy, Kenneth L. Trefftzs Chair in Finance and Vice Dean of Faculty and Academic Affairs, USC Marshall School of Business
3. David Yermack, Associate Professor of Finance, Stern School of Business, NYU
4. Jamie Heard, Vice Chairman, Institutional Shareholder Services

Rob Daines: All right, my name is Rob Daines, I am a professor at Stanford Law School and co-director of the Rock Center. We will have panels later in the day that will address the specifics of the rule, so our first panel will address some of the broader issues, and we're going to go just as outlined in the program up front.

We'll begin by hearing from Alan Beller, who's already been introduced, who's led the division while these rules were being promulgated. And he'll give us some of the thought that went into the rules. We'll then hear from some of the more sophisticated consumers of the data that will be produced by these rules. We'll hear first from Kevin Murphy who's the vice-dean of faculty and academic affairs at USC and then David Yermack at NYU. Both professors Murphy and Yermack are some of the most sophisticated writers in finance about executive compensation and have written some of the most enlightening articles in executive compensation. So we'll look forward to hearing from them. And afterwards we'll hear from Jaime Heard, vice-chairman of ISS, to talk about how these rules will affect and the

data will be used by institutional shareholders. So we'll proceed as planned.

The last thing I want to mention is that we have scheduled time for Q & A, so we'll hope that afterwards that you'll take note of your questions and we'll schedule time to hear from you then.

Alan Beller: I guess I'm on. Thanks Rob for the introduction. And I'd also like to thank Joe for the opportunity to be here today. Although I must say that when Joe originally invited me to do this, I told him he was putting me in a somewhat awkward position. I left the Commission, as many of you know, only on February 24th, and my last public act in fact was to represent the Division of Corporation Finance in front of the Commission at its open meeting in January, at which the Division recommended the approval by the Commission of these rules as a proposal and their issuance for comment.

Given that history and also given the truth, you can safely assume that I stand by the recommendation that was made to the Commission and that the Commission approved. And I think that you can also safely assume that while as a civilian I won't have the responsibility that the Commission and its staff are going to have to work through the comments, address them, and work towards a final rule, I will certainly have a keen interest in those comments and the outcome.

So given what I'm not going to do, I guess people could also safely ask why am I here. What I told Joe and Rob what I would do in the few

minutes I am going to speak is. . .I've thought a lot, both before I got to the Commission, four-plus years ago, and certainly during my four years and a month there about the rule-making process. And what I thought I would do is share my thoughts on some of the issues and competing considerations that arise in providing a framework for a rule proposal like this one regarding executive compensation.

There are a very substantial number of items I could talk about under that rubric, but I'll limit myself in the allotted time to four of them. One, first, is considerations regarding making the disclosure framework value-free. The second is considerations of comparability versus utility. The third is what I call the apples-and-oranges problem, which is particularly interesting in this rule. And the fourth is the old chestnut that we've been talking about for years, and which comes up here again, which are considerations regarding principles-based rules versus proscriptive rules.

On the first one, a value-free framework. The Commission in the proposed release, Chairman Cox and other commissioners at the open meeting, and indeed the Chairman in his remarks a few minutes ago pointed out one respect in which the proposal at least seeks to be value-free, and that is, it's a disclosure rule. The purpose of the rule is to provide materially complete and accurate disclosure, and to let investors have that information and use it as they see fit. It's not a rule that's designed in its proposing stage, at least, to lead to a particular result with respect to executive compensation.

There are obviously many who share that approach. There is in the public commentary even to-date, and I guess particularly before the rule came out, some indication that there are others who hold a different view. That the Commission will not have succeeded in its mandate unless it produces a rule that results in the reigning in of executive compensation. The proposal is value-free in that it does not address that.

There are also participants in the debate who have even suggested that they are fearful that the rule, because of the Lake Woebegone effect, all executives are above average, will lead in fact to an increase in executive compensation, because clear disclosure of what executives at company A, in fact make, will lead the executives in company B and their comp committees and their boards of directors to believe that they have to pony up more to the executives of company B. The proposal doesn't address that, either; it is value-free in that respect as well.

A second important respect in which the proposal seeks to be value-free -- and any proposal in this area to be value-free, I believe very strongly, has to capture all compensation. I can't talk about cause and effect. Maybe the economists on the panel can do that. But I can talk about coincidence, and there is certainly a coincidence since 1992 of compensation being awarded in disproportionate amounts compared to other types of compensation where there has been less than complete and less than clear disclosure of what that compensation has been. A clear example is retirement and other post-employment compensation.

The 1992 rules address those areas less completely than other types of compensation. The compensation in those areas has grown disproportionately. Is there a cause and effect there? I can't tell you that. Is there a coincidence there? I can certainly tell you that.

The last value-free point I will make -- and I think it has to be recognized in comparing the '92 rule to what's out there as a proposal. The '92 rule is, I submit, is not value-free in at least one respect. If you combine the disclosure of the performance graph and you combine that with the disclosure requirements around the comp committee report, I think you find in the rule somewhere between an invitation and a predisposition for committees to discuss their motivations in granting compensation based on short-term stock performance. The proposal that's out there for comment, I think it is fair to say, seeks not to do that.

There may be many in this room who would roll their eyes at me and say, "What on earth would you want to compare compensation to other than stock performance if you're trying to align executive and shareholder interests?" I guess what I would say is that the reason we've spent so much time in the last few years empowering directors, improving corporate governance, and giving directors both the muscle and the incentive to make decisions about what's right for a particular company is to broaden that horizon. Directors ought to be able to pick the objectives for which they want to compensate their executives. The purpose of the rule is to get clear disclosure of what those objectives are and how the compensation decisions and strategies will

deliver on those objectives. The proposal does not include the '92 performance graph, but I think the more important point here in trying to create a value-free system is that you want the disclosure to be permitted to be broad enough so that it covers all the potential objectives that a board of directors might be trying to reward as opposed to guiding the disclosure towards a particular one or two or three, because I don't think that will get you the complete answer in all cases.

Secondly, comparability versus utility. Obviously the principle objective of any set of disclosure rules, and this is true of these as well, is to get material information to investors as succinctly and transparently as possible. The executive compensation area is interesting in a lot of respects, but among those respects is that it is used by academics and others to produce comparative studies across companies in ways that I think are more common in the exec comp area than maybe any other area except for financial statements and various kinds of financial reporting. And so there is a lot of interest in having rules that permit comparability across companies; that permit studies across companies and across time. Indeed, one of the reasons for the highly formatted tables in the proposing release makes this point. The highly formatted tables of 1992, which are largely continued in the proposal, are to permit that kind of comparability. And I think I certainly recognized that comparability is important.

There are some areas, however, in which the desire for comparability bumps up against what I would call the desire for utility, that is, to get material information to investors. Let me get you just two examples. One is an example from the existing rules. One is, I think, a potential issue that the Commission will have to address in the proposal.

In the existing rules there are two columns in the options table which require the calculation of the value of options given a 5 percent and a 10 percent increase in market price. Absolutely clear that those columns are designed, again I'm not sure they're used, by economists and academics and others, in producing studies that are comparable across companies, but they were certainly designed in part that way. However, they use such an arbitrary set of assumptions across all companies in ways that are frankly in many cases just not applicable or realistic that those columns are of pretty low utility. And they are not included in the proposal for a couple of reasons, and that's certainly one of them.

In the proposal -- it's clear from the proposal that one of the things that the Commission is most looking for improvement in over the existing situation is retirement and post-employment pay. There's inherent uncertainty in calculating what retirement and post-employment pay and compensation will be. You have to make a variety of assumptions as to what the situations that will trigger those payments will be. The proposal basically calls on each company to make what it considers reasonable assumptions and disclose those assumptions and produce a number or a range as to what would result. I think paramount in the

thinking there was to get useful information to investors; the utility prong. I am sure, if it hasn't happened already in the comment process, and I don't know whether we'll hear it today or not, but there is certainly an argument that by asking companies to disclose retirement or post-employment pay under a standardized set of assumptions, take-over for all cash at a 15 percent premium of the closing price at the end of the fiscal year, for example, you would get more comparable numbers. And I think the question that faces the Commission in dealing with the issue here is, what's the right balance of comparability versus utility? And I think that is one of the things that will have to be considered in light of what I expect the comments will be.

Third issue, apples and oranges. What I'm referring to there, I think certainly one of the most difficult issues in crafting this rule is. . .it's an imperative, I think at this point, and certainly the proposal treats it as an imperative, that there be a single number given for total compensation. That has been commonly held up of as one of the principle criticisms of the '92 rule, and the proposal does work towards a single number. That leaves a big apples-versus-oranges issue. What I mean by that is that compensation that can be easily determined as a current matter is relatively easy to deal with. But compensation that doesn't have an easily determinable current value -- and by that I'm thinking particularly long-term incentive compensation, you could think similarly about deferred compensation, should it be present valued and so on and so forth -- are less easy to calculate on a current basis.

In the proposal, the way that equity-related long-term incentive payments, like stock options, are dealt with is to use the FAS123R methodology for valuation determined by the FASB. There is an issue there, which I think the release recognizes, and I'm not sure it's been seen in the comment process yet, but it's certainly been seen in the press. FAS123R was intended to determine cost expense to companies, not value to executives, and therefore is an inappropriate methodology to value option payments as exec comp. That is a statement that I think the Commission had to deal with at the proposing stage, I know, and will have to continue to think about. To dismiss 123R out of hand, I think is to ignore two realities, at least, however one of which is that it's there, and it does provide a methodology which otherwise doesn't exist. And secondly, I think to dismiss it out of hand ignores the fact that there are a number of executive compensation disclosure calculations, both in the existing rule and in the proposal, where incremental cost to the company is in fact the measurement methodology. But the whole issue of how to value options for purposes of exec comp is one of the oranges problems.

The other oranges problem I'll mention is that [with respect to] non-stock related long-term incentive payments, there is no methodology comparable to 123R out there. The proposal treats those payments the same way the current rule does, which is to treat them as current comp when earned. That is inconsistent with the grant date methodology for stock options. Given that there's no generally recognized methodology

for non-equity related payments, I think the Commission, at the proposal stage, decided to go with the current methodology. I think there will be some comment; there has been already. [Unintelligible] the commission should come up with a methodology which permits grant date valuation of the non-equity related payments as well; a tall order, but an issue that does have to be looked at and was looked at during the proposing stage.

Let me catch up with the last one, which is this issue of principles-based versus prescriptive disclosure. In many respects it's a false debate because almost all of the Commission's rules come down somewhere in between with a combination. There is something to it though, mostly in thinking about not where the Commission comes out, but in thinking about the competing considerations that the Commission faces and the staff faces in drafting a rule and in making recommendations. In the exec comp rule, this issue comes up and is going to come up most sharply in the area of compensation disclosure and analysis. The proposal takes a very principles-based approach to that. There's already been some comment that a more prescriptive set of rules would be appropriate. There's no single right answer here. The Commission almost always lands in a spot where there's some prescription and some principles-based formation around it.

Prescriptive rules produce disclosure on specific issues that are of paramount interest at the time the rule is drafted. That's good. But it may be easier for issuers not to disclose things that are covered by the prescriptive rules even though they might be material to investors.

That's less good. And when times change and other major issues become important and they're not covered by the prescriptive rule, that’s also less good. And that's the set of challenges that the Commission faces.

I note, in closing that I think the Commission, I think, can claim great success with what I think is the agency's most principle-based set of rules, which is management's discussion and analysis. Disclosure under those rules has evolved to meet changing conditions. Enforcement has been successful in addressing serious deficiencies as they have evolved over time and even though they're not covered by prescriptive rules. It's true that MD&A has required ongoing Commission attention. The staff, through the comment process spends a substantial amount of time on MD&A. The Commission has put out a couple of interpretive releases in the '80s and most recently in December of 2003. And to the extent that compensation disclosure and analysis ends up being more, rather than less, principles-based, it is going to be, in effect, required for that approach to be successful, for the Commission again to continue to pay ongoing attention to the disclosures, both in terms of the comment process in terms of enforcement and in terms of appropriate interpretations by the Commission as it gets experienced with those rules. That is one of the consequences of a successful principles-based framework. And I'll conclude there. Thank you.

Kevin Murphy: That's a hard act to follow. Of course I like the new proposals. It's giving details on many elements of pay that we've been lacking for a

long time, especially the perquisites, the post-retirement pay, that haven't been available until, we have to wait for divorce proceedings. So it's actually quite comforting to be able to find out what people are going to get.

But I want to return to something that Joe started off with on the introduction when he said it'd be nice to get a set of academics who don't have this vested interested in what's in these proxy statements. And I have to issue a disclaimer. I feel a bit fraught evaluating these because I value them for my own personal self-interest. People like David (Yermack) and I are aggressive consumers of these data. We use them for our research, for our teaching, for our consulting. As far as I know the SEC's purpose in mandating disclosure is not to support my teaching, research and consulting, but it just worked out that way, and I am very grateful.

And in actuality something that would be useful for me is to hear what the compelling case is for disclosure. We talk about it being for investors, but we know that investors aren't the only consumers of these data. They might not even be the most notable consumers of these data. We know the shareholders, at least to this point, don't vote on compensation plans. They're not the ones determining pay, so it seems like disclosure is really serving two purposes, or at least the compelling case for disclosure. One is that it's giving investors information on whether the board of directors are doing one of their most important jobs, which is the hiring and firing and setting the pay of the CEO and the other top managers. It also provides information

on what is the single most important conflict of interest between managers and shareholders and that is the setting of their own compensation.

But it would seem, in order to assess a disclosure plan, we need to start with a clear statement of why do we have disclosure in the first place. I don't want to focus on this too much for the sake of my research, consulting and teaching because I use these data and I actually like the new proposals a great bit for what I do with them. The devil is in the details, almost always. And that's what the rest of the panels today are for, so I want to make some general remarks and not get into any details, but some general remarks and predictions, I suppose.

One is, I'm concerned the proposals will not make pay easier to understand. For us connoisseurs of this information it gives us a much more complete picture of how people are paid. And so for people like David and me, these proposals are great. We're going to understand a lot more because we can get into the details. We never looked at the old 5 percent, 10 percent option rule anyway. That was arithmetic. We can do that. We actually never looked at the performance graph, because we can compute that by ourselves, too. But a lot of the details in here we just didn't have before, and that's terrific.

But for the typical shareholder, I do worry about the data deluge of tables. More information isn't always preferable to less information, especially when we ask the first question, why do we have disclosure in the first place? Is it to keep check of what the board of directors are

doing, what they're supposed to do? Well, how much data do we need for that? I worry a lot about the apples and oranges problems, not only in terms of -- the value versus the cost to the executive. . .as long as we understand that's an issue it would seem like what the investors should care about is what's the cost to the company of granting this compensation. And there I'm fairly comfortable that 123R is a reasonable way to go.

We know that we're continuing to conflate, because it's just so hard not to do it, expected levels versus realized levels. I was intrigued by, I think it was Mercer's comment that said, "Why don't we add another table. One table that's all expected, and one that's all realized. At least that would make it very clear which is which." I'm hopeful that the CD&A will actually result in plain English and not turn into boilerplate, but I will, as an active reader of history, I remember after 1993 that the first year or so I wouldn't describe the statements by the compensation committee as boilerplate. Boilerplate evolved over time. It only took a couple years before we really got into boilerplate. I suspect there will be a lot of correlation across companies within a couple of years with what their CD&A says, too.

Another general point is – this echoes –

[break in audio / then resumes]

Kevin Murphy: -- following the 1992 disclosure rules, about a year later, Canada introduced the first ever disclosure rules for companies on the Ontario

exchanges, and their pay exploded, and I think this is a Lake Woebegone effect. It's one thing to be able to say, "Hey, you're at the 75th percentile," which is what they consultants were doing already. Another thing to say, "You mean I'm being paid less than Joe over there or Fred over there? I need a pay raise."

We know that, and I guess this is a counter-example to what Alan was saying about a disproportionate amount of pay going into things that aren't recorded. We know that one of the biggest changes in '92 was much more details, tremendously more details about the stock option grants. Went from saying what the number of options you were granted this last year to having multiple tables that gave the details of options granted during the year. And we know what happened to option grants since 1992, they just exploded. We know the golden parachutes back in the '80s weren't used all that heavily until the government came in and said, "We're going to put tax penalties if payments are greater than three times pay," and it was like a flag going up saying, "Oh, we're supposed to have golden parachutes that pay three times pay," and a lot of companies introduced those following those rules. But by the same token when we start adding all these tables of here's the perquisites, here's the retirement benefits, I think we're going to see a lot of companies who don't have them, introduce them, just as we've seen companies that were paying less than a million dollars in salaries say, "Oh, I guess 162M says we're supposed to pay a million dollars in base salaries."

Another general observation -- it's just worth keeping in mind that executive compensation is a moving target. Clever executives who want to hide their pay will devise innovative new ways to be paid that do not show up in any filings prior to divorce filings. This isn't saying that this isn't a very good start and answers most of the questions that we currently see, but let's be realistic and realize that we'll need to have updates as executives invent more ways to be paid. It's like putting your finger in a dike when there's a leak. You'll plug one leak and another will show up somewhere else. It doesn't mean we shouldn't go down this route, it just means we should go down there with our eyes wide open.

So my summary then is that these new rules aren't a panacea for so-called runaway executive compensation. At least for my own selfish purposes, and it's hard to separate in my mind my own selfish purposes from the better good of the world, I support them and I think they're a great step.

Rob Daines: In the interest of full disclosure David Yermack's next and he also has a conflict of interest, although just to be balanced, these new rules will actually harm David's research interest. He has a data set which -- you've been hand-collecting data -- so to be balanced it will hurt his interests.

David Yermack: Yeah, I mean, I'm an active consumer of the data, as Kevin said. And I'm actually quite pleased with what has been produced by Alan and his staff. I think the reforms here are long overdue. And it's not all

surprising to see what has happened. As Kevin talked about a bit, there's been a cat-and-mouse game that goes all the way back to the 1930s. The first disclosure that the federal government required on executive pay was in the Great Depression. It actually predated the SEC, and there was a Senate committee that subpoenaed every public company to send in the salary and bonus of its top two officers. And compliance with this was, at first, resisted.

There were really three grounds. One was that companies said this was private information of the officials involved. And this was before the Warren Court, in Griswold vs. Connecticut, so that argument didn't get much of a hearing. I think 30 years on, it might have actually made a difference. Companies also said that this was competitive information; that if they knew what the CEOs of their competitors were making that they might raid each others managers, set pay scales differently and so forth. Basically they were overruled on this point due to the commerce power of the federal government to regulate this area.

A third point that came up was that a number of companies said that it was a safety issue. That their executives might become kidnap targets if it were widely known how much money they actually made. In other words, the shareholders might become so angry that they would attack the chief executives and expenses would be needed for security and so forth. And I think that's not unlike the way that Chairman Cox framed the issue - that Main Street investors care about this very much. And simply the fact that they care and at times are outraged by

it is reason enough to require disclosure. I'm not sure that's the way that an economist would really put the issue. And I'm not even sure that that Main Street investor exists today the way that people like to imagine the family at the kitchen table picking stocks and so forth. I mean it's really big institutional investors and mutual funds who are the ones who need this information and who will use it most intensively.

But the reason that we should have it is that there's a lot of research on the record that shows that you can look at the manager's contract. Are they paid in options, in pension, in perks and so forth? And from that contract you can infer, with a great deal of accuracy, how they're going to run the firm. You'll know which firms are likely to try to make acquisitions, which ones are like to resist acquisitions, which ones will take risky investments, which ones will pass them up, which ones are likely to diversify, which ones will stay focused, and so forth. The way that the manager's rewards are being handed out tells you an awful lot about how they're going to manage the firm. And I think there's very little information that investors can get that is more helpful to them than a look at the manager's contract to see how they're paid.

As a consumer of the data, I've been somewhat troubled over the last five to six years, because it's become clear to me that the United States has fallen behind the British in this area. For many years, we really set the worldwide standard for how to disclose executive pay. And there was the cat-and-mouse problem, where the SEC would establish rules and executives would find loopholes or contract around the rules and

then the SEC would catch up 10 years later. But what has happened. . .I think the '92 rules, you mentioned that Canada had stepped in a year later, and now there are a number of countries writing rules in this area. The U.S. is no longer the best country, and this has not been true for a number of years. And I think simply for reasons of pride and leadership, we should seek out the best practices around the world, emulate them and try and improve on them.

And the one area in particular that I think is very important to look at is stock option holdings. Almost everybody agrees that stock options are the number one source of incentives for executives. There are many other interesting things about golden parachutes, perks, pensions and so forth, but at the end of the day, the real bulk of performance incentives come from stock options. And in '92 the disclosure that was required for existing stock options was simply to count up the number of options outstanding, and list the dollar value by which they're in the money. And as far as I can tell, the current proposal does very little to improve on that.

The British, in contrast, have done exactly the right thing. And I've actually produced an exhibit, which is in your binder. They list out, for each executive, a simple inventory of every option they have, what's the exercise price, and when it expires. And the real trouble comes when an executive is holding out-of-the-money options, which, in this day and age, there’s actually been quite a few of those the last five years after the burst of the bubble in 2000 and 2001. Under current disclosure out-of-the-money options are simply recorded as

zero, you know, that we have X number and that they are out of the money, and you can't really go beyond that. But the British tell us, award by award, how much they're out of the money by, and how long the executive has to catch up, and so forth. It's an approach that is elegant in its simplicity and much more worthwhile than what's being proposed. And I hope, in the room, the people who are actually writing the rules are aware of this and will take a long look at it before the final rules go to press. This is the number one area where the rules can really make a difference by casting light on what executives are doing, and I think it would be shameful for another 14 years to go by and the United States not to conform to what's being done in other jurisdictions by other countries.

There's wonderful stuff in this proposal about perks, deferred compensation is what I think is the number one area of opacity, where I think we're going to get a lot more clarity and a lot of good research opportunities. But I think it's important that the staff not take its eye off the bread and butter, which is stock options, and look overseas, across the pond, at what the UK is doing, because it's really quite excellent stuff. That's what I came here to say, and I hope everyone's heard it.

Jamie Heard: Thanks. I thought I'd start by asking what problem or problems we're trying to solve. Some people think there isn't a problem and that everything works fine. Others would say pay is too high in an absolute sense or that the disparity between pay at the top and rank and file pay is too great. Others would say we have high pay for poor

performance, and others would point to abuses of perks or overly-generous retirement plans. I don't think the Commission's proposal will end this controversy. I don't think it can, and as I think has been pointed out here, there are many consumers of this information, and shareholders are not the only ones.

Having said that, I think the proposals really do serve three important purposes. They will improve transparency, number one. Number two, they will promote board accountability. And number three, they will enhance the quality of shareholder oversight. So let me go into each of these briefly. Regarding transparency, here I think just about everybody on this panel would probably agree that this is major, major improvement, what's being proposed. We are not getting the full picture today, and the Commission's proposal takes us great steps forward.

Let me tell you the questions that we and institutional investors are trying to answer when we look at executive compensation. And I think as I ask these questions, I would say in most respects, the proposals really do help us to answer the questions. How much are top executives being paid? Number one. Number two, what are the components, all the components of pay? Number three, what are the targets for incentive compensation? Number four, what did executives do to earn their compensation? And number five, given performance and return to shareholders, is the pay deserved? Those are the kinds of questions we are asking and trying to answer, those are the kinds of questions that institutional investors are asking and trying to answer

and the data that's going to be provided by these new rules is going to help us and institutional investors answer these questions better than we can now.

If I had to make one single recommendation with respect to transparency and the questions I just raised, it would be on the targets for incentive compensation. And here I think we really need to know the specific targets. Not in general terms, but very specifically. And largely I don't buy the idea we can't give investors this information without divulging confidential data. Some companies have already made this information available, and to the extent that you disclose at the end of the period as opposed to the beginning of the period, I think you mitigate any concerns about competitive or confidential data.

Now there are those who have said, I don't know that it's been said loudly on this panel, but you hear it at times, that more disclosure is simply going to fuel abuse. That the more that everybody knows what everybody else is being paid, the more things get ratcheted up. Now for those who argue this, I'd say there's an answer, and the answer is: If that happens, somebody is responsible. And who is somebody in this case? Somebody is the board of directors.

So that brings me to the second objective, which I think the proposals serve, which is to promote board accountability for executive pay. Certainly oversight of executive pay is one of the major responsibilities of directors. And certainly we want to do everything we can to make directors feel accountable for what they are doing. For

this to happen, I believe the Commission's proposals have to underscore board responsibility. And the proposals have to be written in such a way that directors internalize that sense of responsibility. And I think there are, in this regard, some changes that could be made to advance this objective. Most importantly, the CD&A should be a report from the board, not the company. The scope of the CD&A should be expanded to include the entire compensation disclosure section of the proxy. And the report should be issued over the names of the compensation committee of the board, or the board as a whole if there is no compensation committee. These three changes that I mentioned I believe will do a lot to help directors feel that sense of responsibility, and a concern I have is that if we don't make these changes, a year or two from now we'll be back to boilerplate.

Other provisions of the proposal that I think will promote board accountability include requirements for better disclosure of perks, change in control, severance agreements, and retirement arrangements. There are some things that should be left as is, and not be changed. And two I would point out are, you should not raise the ceiling of disclosure for related party transactions -- if anything, you should lower it. And you should not drop the current requirement to publish the performance graph. Why do I say that? Because disclosure in the related party transaction section of the proxy is probably one of the most important in terms of assessing the independence of the board with respect to compensation. And why do I say keep the performance graph? Because I believe, notwithstanding other opinions, at the end of the day for investors it's return to shareholders that matters most.

Having that graph there, I think is another way to encourage directors to feel that responsibility to answer the question -- one of the questions that I posed: How is pay looking given the performance of the company and the return to shareholders?

Third objective I think these rules will serve is one that hasn't been mentioned here today, but I think is really important. The new rules I think will help to improve the quality of shareholder oversight. Now shareholders do have a limited role to play here in the compensation area. One thing that shareholders do is to approve long-term compensation plans involving grants of equity. The data that's in the proposed rules, I think will enable us and institutional investors to do a better job of evaluating those plans. But more importantly, I think the proposals will help us and will help institutional investors look at the performance of the board, and make judgments about the performance of the board.

I'm sure Alan's still got scars all over his back having been through the shareholder access debate a couple of years ago. I think it was unfortunate that the Commission didn't adopt the proposal that would allow shareholders to nominate their own candidates for director and have those nominees included in the company's proxy statement and perhaps someday the Commission will revisit that rule. But I can assure you that there is still a lot going on in the governance world involving shareholders and boards and dialogue over compensation. We see every year -- we're getting to the beginning, actually, of proxy season now. We're going to see director-withhold campaigns. We're

going to see more and more companies adopting majority vote as opposed to plurality election of directors. So the election of directors, while it's far from the system we'd like ideally, change is moving in the right direction, I think. Withhold votes for directors are a potent device, believe me. And with a move toward majority vote, they're going to become even more potent.

The types of information that will be provided in the proxy statement, and the requirement that boards account for their decisions, I believe will be scrutinized very carefully by shareholders, and I guarantee you will see shareholders making use not only of withhold campaigns for directors with respect to pay, but in the very near future you're going to see 14 A shareholder resolutions, whether they be precatory or bylaw amendments, which are going to ask companies to submit the CD&A proposal from the board, which I hope is the way it turns it out, to shareholders for their ratification.

David mentioned the UK is ahead of us on disclosure. I'd say they're also ahead of us on this area. This is exactly what goes on in the UK right now. And it has proved, I think from my experience in looking at it and talking to our clients, it has proved to be a very worthwhile device in providing shareholder oversight in the compensation area. Thanks very much.

Rob Daines: We have 10 minutes left, but I thought I'd give the panelists a chance if they have questions for each other. All right, then we'll take questions

from the floor and you can either shout or make your way to the mike in the aisle. I see a hand there. Floyd Norris.

Floyd Norris: I'd just like to have Alan Beller [unintelligible].

Rob Daines: The question was what you thought of David Yermack's suggestion for option disclosure.

Alan Beller: I think I'm going to overtly duck that and leave it to my successors. I understand the point. I think you have to think about the costs of even more disclosure in what is going to be a pretty thick package, but I understand. If it's $1 out of the money and it has 10 years to go before it expires, it's different than if it's $10 out of the money and has a week to go before it expires. And it is correct that neither the current rules, nor the proposal would differentiate between those two out-of-the-money options, which I think is the point. Black-Scholes values options, not just on grant date, but everyday between the time they're granted and the time they expire. And what David is suggesting the UK would do is, in effect, allow people to make those kinds of valuations of the full set of option packages that executives own every day or every year.

I think the point that options have historically been the big enchilada when it comes to incentive compensation is an exactly accurate one. I think the other one on which disclosure has been much more opaque up until now is deferred comp. There's a lot of money currently undisclosed under the rules that's being piled up in deferred comp

plans. Those are the two areas of greatest opacity I guess I would identify.

David Yermack: I agree completely with deferred compensation being an important dumping ground for secret compensation. And absolutely the Commission is going the right direction in that area. Again the UK has had excellent disclosure of pension compensation for a number of years, and the Commission appears to be mimicking fairly closely what is done in the UK.

The point on the cost of disclosure for options though, I've made this proposal to other groups for a number of years, and one always hears, "This will be too expensive." That's exactly backwards. What is required now is to take the individual awards and aggregate them and do some sort of mathematical computation. That takes time, money, cost, whatever. I just want the raw data, and don't bother with adding them up. If you find that expensive, I can do that for myself. The only real expense is ink, and in the age of the Internet, I'm not sure that that is particularly important either, because we tend to get these things online now, and not have to worry about cutting down trees and printing them. The expense is a smokescreen thrown up by industry and no one should fall for this as a valid reason for not doing this.

Nell Minow: I'm Nell Minow from the Corporate Library. I want to agree with the last point. If they don't want to know how much they're paying out, then we've got something to worry about. But my question for you is this: We've talked a lot, we've really focused on the CEO

compensation, but of course the disclosure rules apply to the five highest paid officers of the company. But I really wonder whether we need to know what the corporate secretary gets paid? Aren't we really more interested in the five highest paid executives of the company, and isn't there a lot of dodging around that loophole that it's only the five highest paid officers that need to be disclosed? Don't you think it would be worthwhile asking the companies to disclose their highest paid executives, not just their highest paid officers?

Rob Daines: Did you want to pick a target? [Laughs]

Rob Daines: Is it for anybody in particular?

Nell Minow: [unintelligible]

Jamie Heard: To some degree, Nell, I think the proposal does do that by, I believe there's a proposed requirement that the three most highly compensated non-executive directors have their pay disclosed in addition to the five that are usually on the chart. I guess in our experience the five who are on the chart, in the vast majority of cases, are the people who are making the key decisions in the business. And if you're in a business like investment banking, let's say, or hedge funds or even entertainment, perhaps there are non-executives who are making a lot of money, perhaps for very good reason. And maybe that gets picked up along the way in the proposal.

Male Voice: Is anyone else concerned, though, about identifying those five based on total compensation received in one particular year? We know that there are a lot of things like lumpiness of stock option grants, signing bonuses, other things that can get one individual in there for one year, and not for other years, which also creates some sort of biases. And Nell's question is a little bit different too than what Jaime answered, because non-executive officers is a lot different from non-executives. I think for many of these companies, for General Electric, maybe Jay Leno is one of the top five. They won't identify him by name, they'll just say a late-night TV host, so we won't really know who it is. I'm not really sure what purpose that serves.

Male Voice: I guess that would be the other question I have would be what purpose is served? What would be the objective for having the data for the others? Is it just curiosity or is there something beyond that?

Male Voice: Isn't Nell's real question, why aren't you requiring division heads, subsidiary heads, and the heads of major units to be treated as executive officers in the first place? I don't care about Jay Leno, but the guy who runs NBC or runs NBC Universal, I might want to know about him if he's paid more than the head of corporate development or whatever. GE doesn't have the problem, but there are companies where there are corporate function placeholders who are there, and where the big division heads or the big subsidiary heads aren't there, and where you suspect they, in fact, get paid more. So why isn't that being answered?

Rob Daines: If somebody has a 30-second answer, we'll --

Male Voice: The 30-second answer would be, I think that the existing rule is intended to pick up the people you're identifying and I think the proposing release actually clarifies that. So if you have someone who is the head of an operating subsidiary who has the functional role of an executive officer within the consolidated entity, that person ought to be picked up as one of the NEOs if he or she is in the top five. That's certainly, I think, the purpose of where we are today. And as I say, the proposing release tries to emphasize that.

Rob Daines: I'd like to thank the panelists and those who've asked questions.

[Applause]

Joe Grundfest: If we can get our next panel up here. We're going from strength to strength. The remarkable panel that we've just heard; another remarkable panel just starting.

Let me just say that with regard to David Yermack's observations that the British do it differently and maybe here the British actually have something to teach us colonials, I agree with him entirely, and we've handed out some additional material that you'll see, which is if you stop and think about it the SEC had a 300-and-some-odd page release. You wonder, "How could they have left anything out, when they've actually had 300-and-some-odd pages?" What you'll see is a handout, which contains a proposed new table, which tries to get at some of the

information that Professor Yermack mentioned, along with some explanatory notes. And the goal of this new table would be, rather than give out the underlying data the way the British do it, which is another way to do it, to actually have the company do the computations, and explain to people how the value of the returns, of the wealth to the executives would increase or decrease as the share price moves up and down. And that would pull out all of the information that Professor Yermack was talking about, but this table would look not only at option grants, it would also consider restricted stock and any other derivative arrangements. Some executives believe it or not have, through collars or other derivatives, hedged away a portion of their economic exposure to the underlying stock and the goal of this alternative representation would be to incorporate that information as well.

So there are two ways to get these additional data. One is the British approach, which gives you the underlying information. The second is this approach, which has the company do the calculations, which I think would actually be a very valuable exercise for the company itself; they need to think about it this way.

So with that, by way of some additional background, I hand it over to Professor Larcker from the Graduate School of Business at Stanford who will be introducing the panel.

<u>Panel 2: Disclosure of Compensation on the Assumption that Executives Remain Employed</u>

Moderator: David F. Larcker, Professor of Accounting, Stanford Graduate School of Business

Panel: 1. John Core, Associate Professor of Accounting, The Wharton School, University of Pennsylvania
2. Brian Foley, Brian Foley & Company, Inc.
3.Katherine Schipper, Board Member, FASB

Professor David Larcker: I'd like to express my welcome to all of you. I'd like to highlight one thing. I am from the GSB, the business school. I'm not in the law department. So the Rock Center, going forward, is collaboration between the law school and the business school and I think we're really excited about the possibilities going forward.

So the topic for the next hour or so is what kind of disclosures make sense on an ongoing basis. And the panel after this will be what happens when the executive leaves and the severance. So we're going to stay out of that arena.

We're fortunate to have a fantastic panel. Katherine Schipper is a member of the FASB, a distinguished academic at the University of Chicago and Duke, and obviously a fantastic board member. She told me she's going to refuse to talk about anything related to 123R. So she'll kick off. John Core is an academic as well, a long-time member of the Wharton school, has done some of the profound work in stock option valuation and accounting. And finally, Brian Foley. Brian has his own firm, has a long list of impressive clients, and I think if you read the New York Times and Washington Post or watch TV, you see

Brian engaging in some provocative statements. So we'll kick off with Katherine, then John and then Brian.

Katherine Schipper: My thanks to the conference organizers for giving me the opportunity to speak this morning and, of course, my thanks to all of you for being here. Anything I say represents just my own views and not a position of the Financial Accounting Standards Board. Those positions are arrived at only after extensive due process and deliberation.

Professor Larcker asked me to talk about the SEC's proposals on compensation disclosures from a financial reporting, standard-setting perspective. The purpose of the SEC disclosures and the purpose of financial reporting are similar, and that is, the provision of decision-useful information. But of course it's different types of decisions and that means different types of proposals for different types of information. The FASB is concerned about resource allocation decisions made by current and potential investors and creditors. The SEC is concerned about proxy voting and governance. The FASB, with regard to compensation, wants to show the cost to the company. The SEC wants to show the incentives to top management and the board of directors.

Of course there are also similarities between the SEC's and the FASB's intent. Neither the FASB's financial reporting standards, nor the SEC's proposed disclosures about compensation are intended to regulate conduct; that is it's not a set of rules governing behavior. This point was mentioned both by Chairman Cox and by Mr. Beller earlier today.

Both of them have the intention of providing information to decision-makers without taking a position on how those decision-makers might act on the information. The objective is achieved if the decisions are based on higher quality information.

The FASB has articulated a set of qualitative characteristics that we attempt to maximize in our financial reporting standards. And I'm going to comment on some of the aspects of the SEC's proposals from the perspective of financial reporting standards setting by using some of the criteria we use at the FASB to think about financial reporting. And those three criteria are representational faithfulness, consistency and comparability, and completeness.

With regard to representational faithfulness, the objective is to have the information correspond to what it purports to represent. In order to achieve this of course, the information has to be prepared carefully, and it has to be prepared with the intent of communicating consistent with the objective of the standard.

And here I want to comment on this furnished versus filed change that is proposed by the SEC and commented on in some of the comment letters that I was able to read on the SEC's website. I can't speak at all to the concern that the CEO and the CFO would be unable to certify because they're not present at the compensation committee meetings. That’s not something I would have any knowledge about. I can speak to the concern that seems to underlie the SEC's proposals. And that concern seems to me to be wanting to increase the representational

faithfulness of the information. The FASB has learned over and over again how important representational faithfulness is, and how dependent that representational faithfulness is on the way the standard is actually implemented, the way the information is prepared. A subversive or careless implementation of a financial reporting standard results in non-representationally faithful information. A subversive or careless implementation of a compensation disclosure requirement in the proxy would presumably result in similarly non-representationally faithful information.

It would seem to me that the SEC is concerned about increasing what I would call representational faithfulness by altering the accountability of those who prepare the information. Without commenting on the best mechanism for achieving that, I will say that my own experience as a financial reporting standards setter would testify to the importance of achieving that objective.

My second set of comments pertains to consistency and comparability. With regard to consistency, I think the proposal to show the current year and the last two years makes good sense, so that users of these disclosures can assess the consistency with which compensation has been awarded in recent years. I also agree with the use of a highly-restrictive tabular format. The FASB has learned that when we use a similar restrictive tabular format the information seems to be more readily retrievable by users of financial statements, and also perhaps -- and here I'm venturing into a personal view -- also perhaps prepared

with somewhat more care. I believe the tabular formats assist both comprehension and comparability and consistency.

I heard with interest Mr. Beller's remarks on what I will call surface comparability; that is an apparent comparability that results when numbers that don't have the same measurement objective are added up and presented as a total. He was concerned, for example, about displaying information about post-retirement arrangements. And it would seem to me that there are at least three alternatives, and I'm actually going to recommend one of those. Alternative one is impose a standard set of assumptions. I would call that uniformity without comparability, because the standard set of assumptions might actually be inconsistent with the economics of the commercial arrangement.

The second alternative would be to impose a requirement that management, or whoever's preparing this report -- I guess it might be the compensation committee -- would create its own reasonable assumptions and use those. That would, of course, give an opportunity for, over time, consistency, but perhaps not comparability. The way a financial reporting standards setter would solve this problem, or would try to solve this problem, would be to do neither of those. The financial reporting standards setter would specify a measurement objective, and the one that the FASB would be most likely to use if this were a financial reporting issue as opposed to a proxy issue, would be fair value. And that is, what would the enterprise have to pay to induce a third party in an arm's-length arrangement of comparable credit standing to stand in its place?

The last thing I want to talk about it completeness. Completeness in financial reporting means that all of the assets and all of the obligations that are under the control of a single management that is overseen by a single governing board are on the same financial statements. With regard to the income statement, it means that all the changes in those assets and obligations appear on a single income statement.

In financial reporting the purpose of accounting for compensation is, as I said earlier, to show the cost to the company, so types of compensation don't really matter so much for financial reporting, it's more total cost to the enterprise. The FASB has learned over and over again that there is no substitute in financial reporting for completeness of financial statements. That lesson is, in fact, one of the reasons for our recently issued exposure draft on defined benefit post-retirement arrangements, where the proposal is to increase the completeness of the balance sheet by moving the funded status of these arrangements from the notes to the balance sheet to display the obligations that the enterprise has undertaken.

The SEC notes that the 1992 disclosure requirements were incomplete. They were less demanding than they might have been with regard to certain items, for example, pensions. Now I think that Mr. Foley will be commenting later on pension arrangements specifically, including completeness with regard to defined contribution pension

arrangements, not just defined benefit -- defined contribution pension arrangements.

If I were going to enunciate a principles-based standard and suggest it to the SEC, I would enunciate a principle that sounds something like this: Any item with a non-zero fair value that is transferred to the covered class of employees and directors must be listed. Now Professor Murphy and Professor Yermack commented on what I'll call the completeness game. Every time the regulatory enterprise, or in our case the FASB, the standards setting enterprise, puts forward a list of things that have to be included to achieve completeness, someone contrives -- and I use that word advisedly -- someone contrives, or structures, or arranges something that falls outside that list. So it is a completeness game. And because it is not possible for me or you or anyone else to foresee the creative ingenuity of commercial arrangement structurers, it would seem to me that it will always be necessary for the SEC to revisit these compensation disclosures with a view toward increasing their completeness.

Now with regard to completeness, for the SEC it doesn't mean that all the compensation for everyone is shown; it means that all the compensation for the designated individuals is shown. And I heard with interest the discussion of how you would know who the designated individuals should be, and some concerns about using year-over-year pay to determine that in the case of these three NEOs. It would seem to me the principle that the SEC would want to apply there is, get the pay for the people who have the influence on

determining shareholder outcomes. And pay might be an indicator of that, but as was pointed out by Mr. Foley earlier, it might also be position in the organization combined with pay.

Now completeness from an SEC compensation perspective would also mean that you'd want to show all the types of compensation separately. The reason, of course, is that these different types of compensation have different incentive effects, and for governance purposes it's important to separate those. Completeness also, I would say, would extend to related parties. One way to transfer a lot of value to someone is to create an off-market arrangement with that person. And without mentioning any names, I think we can all think of arrangements in which related party off-market arrangements transferred value to the counter-party. Interestingly I would say that related party arrangements don't seem to create any incentives at all to increase shareholder value.

Incentives are, of course, also a function of the employee’s wealth. That means that we would want to separate not just by type of arrangement, but by also the change in the employee’s wealth as a function as changes in the state of the world, and also, as pointed out by the SEC, as a function of whether the item is realized, close to being realized, newly awarded, and far from being realized. And Professor Core is going to talk about this in some detail later on.

And finally I want to comment on one last thing, and that's the notion of providing a summary indicator of total compensation. Summary

indicators are both good and bad. They're good, because they summarize, that is they add up and they give you a total. And that means that a person can look at this one number and get a summary indicator. They're also bad, or they're at least dangerous, because users of the information may choose to focus on them to the exclusion of the components. And the example that I would use in financial reporting, of course, is earnings per share, a summary indicator of performance that some believe has been used to the exclusion of focusing on the components.

My thanks for this opportunity. I'll turn things over now to Professor Core.

John Core: Thank you Katherine. I want to thank Dave and the Rock Center and all of you for the opportunity. I'll share a couple of brief thoughts. What I want to talk about briefly is the importance of incentives, and the importance of good disclosure about incentives.

So what are incentives? For executives, incentives are economic rewards when they make good choices, and economic punishments when they make bad choices. For U.S. executives, pay and changes in pay, don't provide very much incentives. It's something that Kevin Murphy and Michael Judson observed almost 20 years ago now.

[End tape 1 / begin tape 2.]

[beginning of recorded material]

John Core: An example. In 2002, Microsoft stock lost 25% of its value. Chief Executive Officer, CEO, Steven Ballmer – that year, his pay went up by 15%. Drop in the stock price, increase in pay. Some commentators would call this "pay without performance." They might say that something's wrong there in Microsoft, but only if they miss the fact that that year – in 2002 – Ballmer's stock holdings went down in value by about four billion dollars. So that’s a big economic punishment for a bad outcome that year. This example obviously was a little extreme, but it's something that you can pick up more generally.

So some colleagues and I studied for the period 1993-2000 S&P 500 executives, so executives of pretty big American companies. We looked at those executives and we found 3000 instances in that period when the stock price fell. Average fall in the stock price was over 30%. Average increase in these executives' pay – these CEO's pay – during that year looking at the median or the typical increase, these CEOs got $20,000 extra even though their stock price was falling by over 30%. So is that something really bad? Do they have bad incentives? No, of course not. During the same period, these executives – their stock and stock option holdings fell in value by over three million dollars. So they were punished by the declines in the value of their stock holdings for bad outcomes for their shareholders.

So the basic point is – pay provides little or no incentive. Changes in the value of stock and stock holdings, the sensitivity of those stock and stock holdings, to shareholder value – those things provide big incentives. As Professor Grundfest is observing with the handout that

you all have, Professor Yermack is observing by his calls for more British-type disclosure – it would be helpful if a proxy statement actually highlighted what these incentives are. So it would be useful, for example, to have a single table that shows how much did the stock price change last year? Did it go up by 10%? Did it go up by 20%? Did it go down by 30%? And then for each named executive, how much did the value of that executive's stock and stock holdings change during the year? Did it go up when there was good performance or did it go down when there was bad performance? If you look at the little table that Professor Grundfest has handed out, you'd also want to know what incentives are on a going forward basis. So we actually see how wealth changed last year.

For the going forward year, what we'd like to see is, for example, for a 10% price change – all you have to do is really for 10% because everything else is just multiplying out. So for a 10% price change in the future, how much would executives's wealth in their stock and stock option holdings go up in a good year or go down in a bad year? That's what their real incentives are and that's what we like to know in the proxy statement.

Now contrary to what's been said here earlier, you can dig this information out of the current proxy statements. So Wayne Guay and I wrote a paper on how to do this. You can compute these numbers from U.S. proxy statements right now, but it's very difficult. So I have a big computer, I'm a researcher specializing in this area – even so, it's hard for me, and I expect it's very hard for the typical stockholder.

Some reasons for this when you think about current proxy statement disclosure – think about opening up a proxy statement. Stock ownership is in one table, option ownership is in a separate table. You want those things together. Right now, option ownership is always measured at the end of the fiscal year, which is where you want it for incentive purposes, but stock ownership is typically measured at the proxy date or some other date. You'd like both of these numbers as a fiscal year end. You want them together. If you've looked at these numbers, and I'm sure some of you have, and you actually want to figure out how much stock an executive owns, you gotta go digging through the proxy statement to figure out how much option is exercisable within sixty days is included in that number. If you've looked at a few of these, every company reports their number a little bit differently. It's very aggravating to try to get the number out of there, so it would be useful if all this came together.

And finally – and this has been discussed a little bit earlier – what you want to know is the value of the options and how sensitive the value of those options are to changes in shareholder wealth. Instead what we have right now is a table that shows a number of options and how far those options are in the money. To me, this is not good because it perpetuates the myth and the misconception that options are only valuable if they're in the money. So clearly those options are valuable regardless of whether or not they're in the money. You can value them with things such as Katherine was saying earlier – that FAS 123 talks

about. So overall, I recommend that incentive numbers be made easier to compute.

The new disclosure does take some steps forward in this area. So I think it's very helpful that there's disclosure about how much loans an executive has outstanding on his or her stock. Clearly an executive that has loans outstanding on their stock, so they're going to lose that stock to some extent if it falls in value and the loans become payable. That executive has much stronger, and I would say different, incentives than the same executive who has no loans outstanding on their stock and instead has lots of money in the bank. So this is a step forward. Ultimately what we'd like to know is actually how much money does that executive have outside their firm? So once the executive's total net worth – a paradox of these things is that the poorer a person is, the poorer an executive is, the cheaper it is to compensate them because you can impose a lot stronger incentives on a poorer person, such as me, than you can on a wealthier person, such as a top executive.

It's also helpful that somewhere in the compensation, discussion, and analysis, a firm is going to have to state its policy on hedging the economic risk of ownership. So this again is a step forward. I would recommend that that information be put in the ownership table. Right there in the ownership table, firms should say, "We do not permit hedging of ownership." If an executive hedges his stock ownership, that hedging removes the economic incentives associated with that stock ownership. So if you've hedged it, there are no incentives associated with it. It would be a real shame if shareholders were to

look at the proxy, see an executive who owns lots of stock and stock option ownership, get the impression that that individual has good incentives when, in fact, that individual has hedged all that stuff out and in fact has none. So if there's hedging that's going on, those ownership interests should not even appear in the proxy statement. That's irrelevant. No incentives, no ownership.

So in conclusion, the new requirements are going to tell us a lot about pay. But what we want to know about is incentives. New requirements make total pay more transparent. This is going to help boards and shareholders get pay right. In the future, these kind of requirements are going to make incentives transparent. And when incentives are transparent, boards and shareholders can look at those numbers, understand those numbers, make them right, and they'll maximize shareholder value by making incentives right and not just pay right. Thanks for your attention.

Brian Foley: Good morning. I first of all want to thank the powers that be at Stanford for giving the little Italian shoemaker a chance to say a few things to you and share a few thoughts.

I come at you as someone who started out as a lawyer with a big Wall Street law firm and worked with a major consulting firm, and for the last 12 or more years has run my own boutique. I am an active consultant. I work with a lot of comp committees. I also work with the press. I have an interest in more data as an investor to some extent, although my ability to invest is certainly restricted by my activities.

But principally as someone who's in the arena and would like to see everybody playing by similar sets of rules and doing the right thing.

I think that the new proposals represent a quantum step forward. I will spend the rest of my time telling you about where I think they fall short, why they haven't gone far enough and what I think they may have missed rather than congratulating them on all the things they got right. To borrow a phrase from someone else – and I forget who first said this – executive compensation is, in a real sense, a window into the soul of corporate governance. It gives you a keen perspective on what matters within an organization.

In terms of the specific proposals, I have the following comments in plain English. First of all, who is advising who? The new proposals require that the comp consultant be identified. That's nice. But I would like to know – who does the compensation consultant, in fact, work for? More specifically, does the compensation consultant already - parent, subsidiary, affiliate, colleague, whatever – also do work for the company, the parent, any subsidiary, any affiliate, any member of management? That disclosure is critical to understanding whether there is a potential conflict of interest, an apparent conflict of interest or more. I would also say that there's no particular reason to stop at the compensation consultant.

Many comp committees hear from more than one outside source. In particular, they hear from the outside law firm. If the compensation consultant should be identified and the potential conflicts should be

addressed, then why aren't we also doing the same thing with the outside law firm that advises the compensation committee? Because they may have similar problems if they also advise management. Obviously if the committee has its own legal advisor who does not otherwise do work for management or the company or any parent or subsidiary or affiliate, fine. But if they don't, I think that that disclosure ought to be there.

Second topic – what I like to think of as "things that go bump in the night in the first quarter." The current proxy rules and the revised rules are entirely focused on what happened last year. They don't tell me what happened in a calendar year after January one and up to the date of filing. I think the majority of major U.S. companies make their grants in the first quarter of their fiscal years. We have four disclosures on that, but we don't find any reference to those grants in the proxy. We don't find any reference to exercises. We don't find any reference to anything new that happens in the first quarter other than perhaps the setting of a new [l tip]. I see no reason why proxy disclosures should not be real time and why you cannot have a separate section in the proxy which says, "And this is what we did since December thirty-one," in the case of a calendar year company.

That takes me into 8-Ks. The new proxy rules will, in my view, somewhat relax and narrow the 8-K requirement. I think that's a mistake. I think if anything, the 8-K requirement ought to be tightened, toughened and – with all due respect to the commission and the staff – enforced. I do a lot of 8-K work. I've heard the professors on the

panels talk about how much they do. I consider myself a forensic specialist. We look at 8-Ks all the time. There is considerable variance in practice with respect to the quality of 8-K disclosure, particularly with respect to retirements and terminations. Without necessarily naming specific companies, why is it that one major financial company within the last two months identified about 135 million dollars going to a former CEO, but left out any reference to 54 million dollars coming out of the tax-qualified defined contribution plans and left out a reference to 10 million dollars of recent option grants that were accelerated in connection with his termination? I can think of a second major company who has an outgoing CEO who had the 8-K fully itemize what he was getting – it just didn't give you any numbers other than the salary numbers.

To me, that's highly problematic. I could go on chapter and verse. So I would encourage the commission and the staff to reconsider the 8-K requirement, which I think if anything should be more robust. I think this is a particular concern because the way the game is played now in some companies is that you wait till the first quarter because then you don't have to disclose for 12 months, 13 months, 14 months depending on whether you have a Form 4 event or not.

That takes me to total compensation. Total compensation arises in two contexts. One as total compensation with a column and one as total compensation the determinant as to who's an NEO and who isn't. We've already heard the discussion about apples and oranges. Everyone realizes that the proposed total compensation column is an

apples and oranges. My concern is that if the goal is to capture all the comp, the proposed total compensation number doesn't come close to doing that. It does not give you a full picture. It gives you one slice, one snapshot, one way of looking at it. If you were to look at the Capital One data on this year's proxy and look at the CEO – the CEO of Capital One who gets no salary, gets no bonus, gets nothing but options – got options with a Black-Scholes value of 18 million dollars.

Under the new proposal the magic number would be 18 million dollars. Well, let's see. Do I think that's a full number? Within the last year, he also exercised options. Those were 249 million dollars. In the prior five years, he had exercised options and realized 226 million dollars. I'm now up to 475. At the end of last year, he had over 300 million options on the table. I'm now at 775 million. Okay, it's an extreme example, but somehow the 18 million number doesn't begin to capture the full picture. I think the goal here should not be looking for a silver bullet single total comp number. The goal should be coming up with a comprehensive picture. And the concern that I have is that the total comp column will, in fact, mislead some shareholders into thinking the number is less than it should be.

Subsidiary to all that, of course, is a concern that the Black-Scholes value is a recognized way of approaching options, but I think we'd all have to also acknowledge that if you actually look at options going out, Black-Scholes generally is not predictive of actual value. I think the academic studies tend to show that Black-Scholes actually underestimates actual values. And at least in that regard, I salute the

staff because the proposal going forward would require you to align dollar amounts actually realized against Black-Scholes.

In terms of the year-end looks, I wholeheartedly endorse David Yermack, who stole a little bit of my thunder in endorsing the British approach. I think it is critical to understanding the leverage that people have in their option position to understand what their underwater options are priced at and what the life expectancy is of those options. But I would go a couple of steps further. I would like to see a recap of all long-term incentive plans currently in progress because there generally are at least two and sometimes three such plans sitting out there. If options have been exercised during the year or rewards have vested during the year, I want to know how many of those shares are still held at year end. Did the executive cash out or is he still in the money? This goes a little bit to John's comment about wanting to have a clear relationship between the year-end reporting and actual beneficial ownership.

Another major area of concern that I have is that the current proposals, like the existing proposals, do not require you to get into history. The example I gave before of the Capital One CEO – by the way, the 249 million he realized is after holding that option for almost ten years with a company where the stock has gone up seven or eight times. So I have to give the man his due. But to understand that 249 million dollars, you have to understand what he's already exercised, which is the 226. Part of what I'm getting at is I think that shareholders should be in the same position that a well-advised compensation committee

would be in. And a well-advised compensation committee will be told what has been newly banked, what's been paid and taxed in a year, what's newly vested but hasn't yet been paid out, and what's newly granted. And those numbers go beyond the simple total comp numbers that are proposed.

On the retirement plan disclosures – on the tax-qualified side, I see no requirement in the proposals, unless I missed it, that you disclose the tax-qualified defined contribution account balance. If it's non-qualified, yes. But if it's tax-qualified, no. There are a lot of eight figure tax-qualified defined contribution balances out there. Why isn't that compensation? In the example I gave before, this one particular individual had 54 million dollars. It was supposedly in a 401K. Actually it was in a number of defined contribution plans that had all poured into a 401K. I think that on the DB side – defined benefits plan side, the requirement should be that you have to give a lump sum figure, a lump sum actual or equivalent, whether you have a lump sum payout or not. The lump sum figure is what really captures it in people's minds. So if you tell someone they're getting a million a year, that's one thing. But if you tell them that the lump sum actual or equivalent is 12 million or 15 million or whatever it is depending on their life expectancy and whatever [actualities] or subsidies there are, that has more resonance.

On the perks side, I applaud the reaffirmation that a perk is a perk whether it's for security or not. I applaud the notion that SIFL, the Standard Industry Fare Level, doesn't come close to capturing the real

value of a private plane. But neither does incremental cost, which is what the commission is now using. Incremental cost is nice, better than nothing, but the fact is that there are very large fixed costs. And not picking up any of those, I think understates the true cost of the company.

On the CD&A – I think the CD&A ought to be under the signatures of either the comp committee or the independent directors. I don't care whether it's under the signatures of the non-independent directors. It's the independent directors that I care about the most. I think it probably needs to be furnished rather than filed because if you're doing it right, the principal executive officer and principal financial officer will not be fully involved in all the deliberations required.

And at the end of the day, I think what you want is a situation where the independent directors, particularly the compensation committee, are the ones who are most accountable. In terms of effective date, the current proposal is to phase in so that you comply fully in 2007 with respect to 2006 date and go forward. Why wait? There's no reason to wait. If you need to simplify a few things, simplify a few things, but I think in 2007, if these rules are adopted, I want year over year comparability. '04 versus '05 or '06, and there's no reason why that can't be done. I think I will hold on my other comments for the moment.

David Larcker: Thanks to the panel. Before I turn it over for questions, I'd like to make a couple of quick comments. One is to John's point about what

equity do you actually own? That's a really important thing. We've actually started looking at this. There's a lot of executives – more than you suspect – that unwind their equity holdings or their stock option holdings. And when they do that, the typical number is about 20%. So we're not fooling around with small magnitudes. Now to dig that out, you have to go to the Form 4s and do a lot of forensic analysis, and it would be nice to see that in one place.

The second point that I think is important follows up on Brian is – when you start looking at the total amount of wealth that the managers hold, the SERPS, or the Supplemental Retirement Plans, are gigantic. For companies that have those, it's roughly the same order of magnitude as their equity holdings. Now if you think about that, the SERP value basically moves around when accounting numbers move around because it's keyed off to salary and bonus. Obviously the value of the equity moves around as the stock price moves around. But it's just not all stock prices. There's a big chunk of this thing that's tied into accounting as well. The SERP disclosure is pretty murky in a lot of cases.

Finally, the other thing that hasn't come up very much is I'd like to know a lot more about discretion. You kind of see this in the 8-Ks now. It's like all of a sudden here's a formula and somebody should be paid a million, and now all of a sudden they're paid two million. What gave rise to the extra million? It may in fact be a good thing, but I think it'd be useful to actually know a lot more about that. So at that point, let me open it up for questions.

Brian Foley: David, let me chime in with one quick item. On the defined benefit pension plans, I would like to see the final version of the rules not eliminate the requirement that you disclose the formula. I don't want to just know what the DB plan is now. I want to know how it moves year over year. And that's one of the nice things that the current table actually does.

David Larcker: Right. And I would think that's compensation. Anybody on the panel want to follow up? Anyone from the audience? Joe?

Joe Grundfest: I have a feeling the people are just being a little bit shy. There's a lot of information here. One of the themes that I get from this panel discussion and the prior panel discussion is that there's a lot of expertise out there in academia that's been operating in a forensic sense – that if you really roll up your sleeves and go through all of the 8-Ks, look at all of the disclosures, add some institutional knowledge that you have to have outside of the documents, you can come to a reasonable approximation of the number that you really want to know. And the number that you really want to know is – how has the executive's total wealth increased or decreased historically with regard to the compensation plans? And how might it increase or decrease in the future with regard to future changes in stock price? Because that shows the extent to which you've got incentive compatibility. That the executives make money only if the shareholders make money, and they lose money if the shareholders lose money. Do you think it would be accurate to describe that as an overarching philosophy that the

agency should strive for? In other words, eliminate the need for you guys to be such forensic experts and target the ability to measure changes in wealth as simply as possible?

Katherine Schipper: Isn't that what I said in my principle?

Joe Grundfest: Yeah, I thought I'd repeat it.

Katherine Schipper: The principle being any time you transfer anything with a non-zero fare value to a person who's in the scope of these regulations listed.

Male Voice: And then emphasizing whether that transfer is defined as a measure of changes in share price where the shareholders, I think, could actually see how they gain or lose along with the executive and whether the measure is something independent of share price where there might be a different set of incentives there as well.

Katherine Schipper: That's a question of disaggregation. I'm going to defer to compensation experts, and I'm surrounded by them here, about the different types of incentives that are set up by different types of compensation. For example, I don’t know what a SERP, a Supplemental Executive Retirement Plan, does to incentives relative to a long-term incentive plan. I don't know that. But I assume it does something.

Male Voice: I would turn to professional Larker.

Katherine Schipper: So the principle you're talking about there is disaggregate by incentive. And you can do this. I can't do this. So the principle of disaggregation that the SEC should use is – take the total transfer of value and split it out by the type of incentive it creates. That would also include taking account of the cumulative wealth transfer of the stuff you talked about. Very principles based.

Male Voice: Yeah. I would be inclined not to limit myself to defining success in terms of stock price. I certainly think that that's a key element of success, but depending on where the company is, stock price may not fully capture real indicia of success. I do a lot of work with companies that are in restructuring. You go from one sad place to the other, but in fact you are much closer to making the turn. I do agree with the notion that there should be a sense on a multiple year basis as to comparing how management has done – total picture, all in – compared to how the company has done. I just wouldn't necessarily limit it to just the stock price.

Male Voice: Can I just say one further thing on that? I think what the proxy forms do a very good job of is show people that read the proxy statement how much did the executives get paid. And that seems to be the focus of the public debate – whether executives are paid appropriately. In the future, I think a much more important question is how are executives motivated? That is something we want to think about going forward. Disclosure of sensitivity, of executive wealth, to the stock price and to other measures is something that we would want to know about going forward.

David Larcker: Kevin?

Kevin Murphy: Mr. Foley brought up the compensation consultants and the role of consultants and noted that the new proposal dictates that companies identify what consultants they use and who hired them – but then suggests that we go a step further and also identify those consultants and what other business are they doing within the organization? Are they the actuaries? Do they do the employee pay practice? Since we have some representatives here from some of the larger integrated firms that do all these things, would they be worried about this kind of proposal or do they think this would be a good idea as well?

David Larcker: Anybody want to step up to that?

David Larcker: Maybe I'm thinking on Paula Todd or Steve here from Towers.

Male Voice: We certainly saw something like this in the accounting firms.

Male Voice: They went a step further and [unintelligible].

Male Voice: Please understand. I have no problem with the big firm doing everything as long as the comp committee has access to and uses somebody who's truly an independent and does not have a foot in another camp. Not doing the outsourcing work, not doing the defined benefit work, not doing the retiree medical work. Because please understand, the money is on the other side. It's not on the exec comp

side. It's the auditor problem. If you're in a situation where you are getting a million to do the audit and 26 million to do other stuff for the company, there is a natural human tendency for there to be pressures on the consultant to perhaps not be as outspoken as he otherwise would be.

David Larcker: So if we picked on Paula –

Paula Todd: I'm Paula Todd. I'm with Towers Perrin and we are a large executive compensation firm that also does actuary work. The conflict of interest clearly is a concern that we have. I think most of the major firms – at least, I can speak for our firm – have set up a lot of policies where we require peer reviews, we make sure the executive compensation consultants are not compensated for other work that's done. We have professional standards officers that do audits from time to time, at least every three years, of these relationships and so forth. So I think that there are a lot of processes.

I think the situation with the accounting firms and the consulting firms is a little bit different because we are not providing an audit opinion. We are providing various sorts of services related to data and analysis and so forth. As Brian pointed out, the executive compensation services are typically a lot less in magnitude. It would be a very unusual situation where the fees for that would be more than a hundred or two hundred thousand dollars a year. And often it's quite a bit less, which is quite different than the audit firm and consulting where the consulting fees tended to outweigh the audit fees.

Brian Foley: The comment that I would make is that I think of the comp consultant going forward as not being a data provider. I think of them as primarily being an opinion provider. What should you be doing? Yeah, these are the data points but from an internal equity standpoint or from a market comparability standpoint, a well-advised compensation committee is pushing its comp consultant hard. Not for hard data, but for hard advice. It seems to me that what I'd say to compensation committees is that their best protection in terms of doing their due diligence and exercising their best business judgment is to have independent consul from both an attorney not otherwise working for the company and a consultant not otherwise working for the company. It just avoids issues that might otherwise arise. Otherwise why name the compensation consultant? What's the point? I regard Towers Perrin as a terrific firm. Certainly terrific competitors. But all the big firms have had issues in some not pretty situations where one has to ask the question how they end up in that particular situation and where the fact is that they have more than one foot in the fire? They had multiple interests. So as a shareholder and as a critic, I want to know that. And I think the SEC should require that disclosure. I don't think you should stop at the compensation consultant.

There are many situations where the outside lawyers are as big a driving force on the compensation decisions as the compensation consultant is, particularly in M&A. I've been doing M&A for 30 years. I did it as a lawyer at a big firm and I've been in the big compensation

consulting firm and have been in the boutique. Not to pick on lawyers, not to say that they don't also have their own Chinese walls.

Paula Todd: May I respond? Brian, to your point – compensation committees are the ones that make the decisions. One of the issues that we have is that sometimes we do work for a company, we are their exec comp consultant, but they don't do what we suggest. So when you name the consultant, what is that implying? And what misleading representations could that cause? Shareholders may assume an endorsement of something that really wasn't the case. I agree sometimes we're data providers, sometimes we're technicians, sometimes we're advisors. Each compensation committee uses their consultants a little bit differently. There are no precise professional standards as to exactly what a particular engagement is, so I think that the concern we have is that it would be very misleading in some cases to simply name the firm and not provide this other information. In the end, it is the comp committee that is making the decisions.

Male Voice: I think that's a fair judgment, but one of the nice things about the new rule is it would require comp consultants to think twice about the comp committees that they do do work for. We've already passed on one comp committee in the last four weeks. We didn't think they were ready to make the changes they needed to make, so we passed.

Paula Todd: Right, and we have resigned from engagements. But then the issue is – if no reputable firm will provide advice to certain compensation committees, how is that going to improve the world?

David Larcker: That's where academics get involved. Thanks for the debate. It's almost lunchtime. Let's see if we can carry this over during lunch. I'd like to thank the panel for some great discussion.

Joe Grundfest: Our luncheon speaker is John White, who's just recently taken over as Head of the Division of Corporation Finance and who will have primary responsibility for absorbing all of the wonderful and excellent advice that you're sharing with the agency today and actually creating the new rules. John will speak promptly at 12:30. I have some advance notice of what John is going to talk about. It is an extraordinarily important and practical set of advice that you won't want to miss. The Chairman observes that advice from John could easily cost you many, many thousands of dollars in the private sector. He will be sharing that advice with you for the grand price of nothing.

The next session will begin at 1:30 and it will take up a set of extraordinarily charged issues – in particular, how will the rules require disclosure of termination payments, payments that exist in connection with changes of control and retirement, and also a provision that many people are just clueless about – how tax gross ups work. These are the provisions that we often call the "hidden ka-ching." These can be big numbers that are very hard to understand. We look forward to you being in your seats at 12:30.

[pause in tape]

Joe Grundfest: It's a rare agency that's able to go from strength to strength in the chairman's office and now also from strength to strength as the Head of the Division of Corporation Finance. Alan Beller has for many years led the division quite remarkably, and the baton has now been passed to John White. The enthusiasm, the excitement, and the outpouring of glee – I can't imagine a better way to describe it – among professional practitioners when the word came around that John was taking over as the head of the Division of Corporation Finance was absolutely astounding. It's a little bit as though your first team was able to get the first draft and you were able to sign Lebron James for about 120,000 dollars a year. Truly a remarkable get.

So ladies and gentlemen, it is an extraordinary privilege to be able to introduce John White, the new head of the Division of Corporation Finance. John will share his remarks but for a variety of reasons – including the fact that he's only two weeks, two days, how many hours and minutes – in the job, we unfortunately will not be able to entertain any questions after John's address. So ladies and gentlemen, I give you John White.

REMARKS OF JOHN WHITE CAN BE FOUND AT http://www.sec.gov/news/speech/2006/spch040306jww.htm

Joe Grundfest: Thank you very much, John. That was excellent advice. I know a small number of companies that have already started

on that, and it's been very very self-revealing what they've learned. We're going to start our next panel in about 15 minutes. That gives you all time to catch up on phone mail, email and the like. Again, the next panel will deal with what we call the "hidden ka-ching." Thanks.

[End tape 2 / begin tape 3.]

Panel 3: Disclosure of Compensation Triggered by Retirement, Dismissal or Change in Control

Moderator: Dan Siciliano, Executive Director, Stanford Law School Program in Law, Economics & Business

Panel: 1.Adam Chinn, Partner, Wachtell, Lipton, Rosen and Katz
2.Tom Kelly, Compensation Practice Leader, Watson Wyatt Worldwide
3. Gregory P. Taxin, CEO, Glass Lewis & Co. LLP

Dan Siciliano: .. I am the executive director of Stanford Law School's program in Law, Economics, and Business. We're happy to present our third panel, which is going to discuss disclosure of compensation triggered by retirement, dismissal, or change in control. We have a great panel today. We are very fortunate to have three domain experts of different sorts and different strengths. They'll give us some thoughts, each taking maybe five or six minutes initially. And then we want to dedicate the balance of the hour to questions and answers, and if you don't come up with good questions and answers, we have already made a long list, which we'll happily entertain you with. But hopeful you'll come up with a bunch. Let me do a quick introduction of all

three, so we save time and can just float through the different presentations.

First I'd just like to introduce Adam Chinn, a partner -- and I should mention the bios are under, and so is the other material, under the yellow tab in your notebook, and bios for all the different speakers today are in that book. Adam is a partner at Wachtell, Lipton, active in the M&A practice, as well as the executive compensation practice. Many of you will know him. He is a frequent writer and speaker on these topics, particularly executive compensation, and he is so sought after as to be the impetus for a term used among lawyers and comp consultants called the "Chinn up." And as my wife, a labor and employment lawyer, puts it, it's kind of like a gross-up, only better. And I think we'll have a chance to ask some questions about that, perhaps. We also have Tom Kelly, a compensation practice leader, for Watson Wyatt, and their primary liaison in this area to ISS. And he was previously, for a long time, I think nine years, with Towers Perrin, prior to joining Watson Wyatt. And then finally Greg Taxin, the cofounder and CEO of Glass Lewis & Company, previously a managing director of Bank of America Securities in San Francisco, as well as the vice president in investment banking at Goldman Sachs. So thank you and welcome to the panel. And we'll go ahead and get started with Adam.

Adam Chinn: Good afternoon. What I think I'll do, as the first off, is just quickly recap what the new rules are on termination and change-in-control provisions. Employment lawyers and executive comp -- we used to be

a pleasant little backwater. No one bothered us. Now it's the hot topic of the day, and we seem to find ourselves constantly on the front page of the Wall Street Journal and the New York Times, although we wish we weren't. The current rules on change-in-control disclosure are pretty simple. Basically the rules say you should disclose the material terms and conditions of agreements with your named executive officers. And for those of you who read proxy statements, the disclosure has tended to be narrative rather than numerical. I would guess, though, given the rest of the disclosure that is required in the proxy statement, with respect to equity comp and a bunch of other things, you can probably work out an enormous amount of the numerical disclosure, although maybe not with tremendous accuracy. So given the huge publicity that certain change-in-control packages seem to have given rise to, the new rules really just ask for a lot more specificity numerically, rather than, I think, a huge change in the narrative disclosure.

The requirements, basically, ask you to give the specific circumstances that would trigger payments under a termination or change-in-control arrangement. You have to estimate the payments and benefits, including the actual value of any increase in pension benefits provided in each termination circumstance, tell people whether they're in a lump sum or if they're payable over time, give the specific factors used by the company to determine the appropriate payment and benefit levels, and then any other material conditions or obligations applicable to the payment of benefits, things like noncompetes, nonsolicits,

confidentiality, and so on and so forth. And then any other material features.

Most of this, I think, is reasonably noncontroversial, except for, unfortunately, a great deal of it is totally unknowable. And the reason for this is Congress's foray into the change-in-control environment in 1984 and then later in 1986, with Section 280G of the Internal Revenue Code, the so called gross-up that so much black ink has been spilt over. And for those of you who mercifully probably don't spend your days worrying about Section 280G of the internal revenue code, here's a very brief synopsis, because this is something that people have written again and again and again about, often with very littlie knowledge of the underlying specifics. Basically what Congress said, after someone you may know called Bill Agee received a $1 million in a takeover in 1984, which was then thought to be shocking to the conscience, was that no one could receive more than 2.99 recurring times their average taxable compensation over the five years prior to the year in which the change in control occurred, without incurring a 20 percent excise tax. So to make life easy, if your average taxable, includable comp for the five years prior to a change in control was $1 million, if you received $3 million or more, any payments you received over $1 million would be subject to a 20 percent excise cut and also would be nondeductible to the paying company.

Now, with respect to cash payments this would be all well and good, and life would be simple, and you'd just have everyone getting severance at 2.99 times their includable compensation. Unfortunately,

it's not your salary and your bonus, it's your includable compensation, so if you exercise options, that increases the amount that your taxable compensation is. If you defer compensation, it decreases it, so Congress basically encouraged activity, which is the nightmare for every company, which is everyone exercises their options and doesn't defer compensation. On top of that, you have to take into account accelerated vesting of stock options, where there's this incredibly complicated formula that I won't bore you with, and acceleration of restricted stock, and enhancement of any other benefit which is contingent on a change in control.

Obviously, a huge amount of that is totally unknowable today. You don't know what your comp will be when there is a change in control. You don't know what the stock price will be. You don't know when the change in control will occur, what options will be vested, what won't be vested, which restricted stock will have vested, will you be eligible for a time and not eligible for a time, and so on and so forth and so on. So basically what's going to take place next year, which is going to be amusing, are going to be these gross estimates, which I frankly believe are going to be more misleading to the public than not putting in anything at all. And I just hope that the SEC is willing to stand there and give all companies an indemnity for when the disclosure that they make turns out to be nothing to do with the actual circumstances when a change in control takes place. The one piece of urging I would have for the staff that is here is that before you impose this never-never-land rule, that the unintended consequences of this disclosure are very, very

carefully considered. And with that, I will turn it over to Tom Kelly, as I think I've used my six minutes.

Tom Kelly: Thank you. I thought I'd give you some context for my remarks, as they relate to the SEC's proposal. Along with other consultants in my firm, I do not believe that the overall executive pay model in Corporate America is broken. We have an increasingly globally competitive economy, and we believe that the superior returns of US public companies, at least in part, reflect the executive pay programs and incentive designs that have been implemented at these companies. And we believe that overall executive pay is highly sensitive to performance, as it was said earlier, particularly if you take into account the sensitivity of total wealth holdings to share price changes. Certainly there are companies where executive pay is not adequately tied to performance, and where the amounts received may exceed what is reasonably necessary to attract, retain, and motivate executive talent. So while the executive pay model in the US may produce poor outcomes at times, it is still a better system than others that have been tried. We see the proposed rules on disclosure, like the recent changes in accounting for stock options and other equity compensation, as another force in the process driving continual improvement.

So turning to the topic of this panel, we do think that enhanced disclosure will definitely influence future practices in the area of compensation received, as the direct result of a termination or following a change in control. Why do we think this? I'd like to give you a few facts. The 2005 study by Executive Compensation

Resources found that 79 percent of the largest companies in the United States provide golden parachute protection to their executives. Now golden parachute, what we mean by that, generally it's a cash benefit of at least two to three times current salary and bonus, plus other benefits in the event termination follows a change in control. Those other benefits are usually quite valuable and usually include the gross-up on the excise tax that Adam just described. Note that this gross-up protection doesn't apply to all income taxes owed, just that triggered by the excise tax relating to 280G. A similar analysis done by ECR in 1987 found that golden parachutes were in place at only 35 percent of the companies, and only 10 percent of those companies had the gross-up protection. So over the last 20 years, we've seen a significant increase in the prevalence of golden parachutes and the gross-up provision.

Last year my firm, Watson Wyatt, did a survey of institutional investors. Most of the participants were public employee pension fund managers. We found that about 75 percent do not see either change-in-control agreements or executive severance arrangements as being shareholder friendly. We know of, last year, about 20 shareholder proposals that called for boards of directors to adopt a policy that would limit golden parachute arrangements received by executives in the event of a change in control or severance for any reason. Fifteen of those 20 proposals received a majority vote of support. That's 75 percent. Most proposals relating to executive compensation have never seen that level of support, so clearly there's a gap between current

common practices at most of the companies and what at least this large segment of the investor population desires in this area.

Why is that? Well, current practice, again, is to start with cash severance of two to three times current pay, and then you throw in all these other benefits, including acceleration of equity values, enhancements to retirement programs, and this gross-up. And yet the shareholder proposals are looking to cap the total value received of that two to three times, so we've got a pretty big difference of opinion as to how these arrangements should work and what they should accomplish. It's highly likely at most companies that when termination follows a change in control, it's going to generate benefits that exceed the IRS limit, and therefore trigger the gross-up.

Over the last year or so, many companies have conducted an analysis that quantifies the total obligation executives will be owed in the event of termination under varying scenarios, including a change in control. You have in your packet an example of one company, Pfizer, disclosed in a table the obligations owed to their executives in different categories in the event of a change in control, as of year end. Well the primary objective of these analyses has been to quantify the total potential obligations for the compensation committee. They often have also resulted in a revaluation of the various provisions. That may look relatively innocuous when on a term sheet, but actually involves significant value to the executives. For example, a fairly common provision, a lot of supplemental retirement plans, in the event termination follows a change in control, the executive may receive

additional agent service credit. You may say, well, two- or three-year age and service credit isn't that different than two or three years of compensation pay. But depending on the executive's age and service tenure at the time of termination as well as the underlying benefit formula, that provision can be of highly significant value for some executives while providing no value to other executives at the same company.

In addition these termination scenario exercises are leading board members and senior management of companies to ask other more philosophical questions: Why do we provide severance guarantees at all? Why is severance so much enhanced if termination follows a change in control? What is it that's so special about a change in control that makes us provide so much more value? Are individual contracts even necessary or should we adopt more of a policy statement that dictates the terms and conditions of severance under various circumstances? Finally, should the value of equity realized at the time of the transaction, have some influence on the level of cash severance otherwise provided?

With regard to these benefits, current practice reflects the view that the primary purpose of such arrangements has less to do with providing a bridge to new employment but with ensuring that executives are relatively indifferent about the potential to lose their jobs as a result of a transaction. Some would even argue that without such arrangements, M&A activity involving two very large companies could be significantly curtailed. The concern of some investors that these

arrangements go beyond their intent, and instead motivate executives to seek out transactions for personal gain, or to protect executives from a situation where poor share price performance leads to a sale, where they can get their benefits anyway.

Will enhanced disclosure drive significant change in this area? We can't say definitively, but we do expect some things to change. We do expect to see individual contracts and severance agreements to decline in prevalence, with more companies implementing overall severance and change-in-control policies that cover a broader group of executives and employees. Some companies will reduce severance and other termination benefits, particularly as they hire new executives or promote some from within, which could create the potential for kind of a dual class of employees at the executive level at some companies. And we do think some companies will adopt severance policies that call for cash severance to vary, depending on the value of other benefits received, including equity values. Regardless of what changes actually occur, we expect severance and change-in-control payments to be very controversial in the future. Thanks.

Greg Taxin: Hi, I'm Greg Taxin. I wanted to talk about these proposed rule changes from the perspective of our clients, which are shareholders, who I think really have two large interests in reviewing compensation-related information, and so I want to lay out what I think the purpose of this sort of disclosure is for shareholders and then tell you some places, with respect to these retirement benefits and change-in-control

compensation, in particular, where I think we may not serve all of those interests.

I think shareholders are basically focused on executive compensation for two reasons. One is to understand the incentives of the management team that are running the company. I think it's not just me. I think it's true of -- shareholders, as well, have a general view that people do that which they're incentivized to do. And if you can understand the incentives of management teams, you can generally understand what they're going to drive toward, and that may or may not be consistent with what you, as a shareholder, desire out of the company, but you've got to know it in order to know where the company's going.

The second way that executive compensation information is important to shareholders is to understand the quality of the board's oversight and decision-making. It's an area that, unlike many others of board decision-making, can be quantified and benchmarked and understood quite clearly. You also get a sense of whether the board is truly independent of management or merely doing the bidding of management. And so these disclosures are critically important, I think, for investors to have a window into the independence of directors and the quality of their work. Let me focus, with respect to the topic we've been assigned here, on these two areas.

In terms of incentives, I think the change-in-control disclosures are a terrific improvement over what we have. There is no question but that

a management team that is highly incentivized to undergo a change-in-control transition will pursue opportunities for such transactions, and similarly a management team that has no such financial incentives will be less inclined to do so. I think it's also true, though, of directors, and there are in corporate America directors who have acceleration provisions, for example, in their option programs, or other cash- or other compensation-related benefits that come from changes in control. As I read this proposal, those arrangements don't need to be disclosed, and I think they ought to be disclosed in the same section with the executive compensation.

I also think there ought to be a more explicit requirement to talk about, in a merger proxy or in a registration of shares in conjunction with an exchange offer, any changes or adjustments that were made to preexisting change-in-control arrangements, as can sometimes happen on the eve of a transaction. Those are, I think, troubling, often, to shareholders, in the sense that they haven't provided an incentive to get to that point. The transaction is often already available to the company, and the desire, then, to pay out gobs and gobs of money to executives doesn't further the economic interest of shareholders.

Under the rules as written, any such registration statement or merger proxy has to include a similar description of change-in-control arrangements but it was not explicitly a discussion of any changes made on the eve of the deal. And I do think that the right benchmark here is cost to the companies. All these gross-ups and “Chinn ups” and other things ought to be valued as best as possible, as a cost to the

company, because ultimately, while shareholders are interested to understand the incentives of management, they also care about what it's costing the company to incentivize management to do those things.

Secondly, I'd say there's an area of incentives that's not touched on by the proposals, which I think needs to be, which is event-driven bonuses. In the release today, there's a discussion of any sort of plan that can drive bonuses, but we're certainly aware of executives that have in their contracts bonuses for spinning divisions off or for raising capital. We recently saw one for getting the company to comply with section 404. That was worth a $1 million to a chief executive. You apparently have to incentivize people to comply with the law now. But I think any other sort of event-driven bonuses will drive behavior and shareholders ought to be aware of what their management teams are being driven to do. As I read these disclosures, I think that falls into the cracks of the disclosures, which are focused really on pay that went out the door, or in the case of these termination payments, pay that could go out the door in the limited circumstance of a change in control. But something like a payment for spinning a division or raising capital or being listed on the NYSE, or not violating the speed limit or not killing your neighbor, are not covered today, as I read these provisions.

In terms of quality of board oversight, I think there are a couple things that could be improved about the current proposal. One is the related party transaction disclosures. This does not fall technically into the topic of this panel, I'm embarrassed to tell you. But changing the limit

from $60,000 to $120,000 in the discussion, in the instructions seems to me will signal really where that materiality line falls, even though the instructions go on to say you should read this as passing upon materiality. I think most people will take the invitation to read that as materiality, and I think in a world where we really care about independence and independence of directors, doing anything that moves in the direction of allowing companies to keep opaque these sorts of relationship is a mistake.

The other thing I'll say, and this now undoubtedly will not happen in this proposal, but I'll nevertheless advocate for it, which is that I think the CD&A -- I think there should be a required vote on the CD&A, I think there should be a listing standard at the New York Stock Exchange, in the same way that we have a listing standard for equity-based compensation plans. You've got to go get a vote to get your shareholders to approve equity compensation. And in today's world, frankly, with 123R, those expenses end up on the income statement. Management's and shareholder's interests are actually fairly well aligned, now, finally, for the first time, on equity-based compensation. But they remain relatively unaligned in some of these areas, and I would think if you had to pick one where there was a required vote, I think shareholders would be best served by actually having a required vote on the CD&A, like there is in the UK.

I will throw in two other comments, again off the topic of this panel. One is I want to be the only person, I think so far today, to advocate for XBRL treatment of this data. It's great that we have electronic

filing, and it's wonderful to go to the SEC's website and pull down documents, but then you've got to hire teams and teams of people to key in this data and to do any sort of comparison that's meaningful. The largest institutional investors in this country own a lot of stocks, sort of by definition. They own hundreds or thousands of stocks. And in order for them to stay on top of this data and make some meaningful assessment of it, today they've got to go and pull down all these documents, hire a team of people in India or the Philippines or some other place, to key in this data and assess it, and I just don't know why we aren't requiring, in this modern era, issuers to file this information in a way that actually can be used by sophisticated institutions that own the stocks and own thousands of stocks. I think the burden is actually quite slight on issuers, and today that burden is, in any event, just being shifted to shareholders, for them to key it in anyway.

The second thing I would say, and this is another sort of minor point, is under Sarbanes-Oxley, there's a very clear provision for the clawing back of compensation that was paid with respect to fraudulent or misstated financial statements. Our firm just finished a survey of restatements and financial statements. There were 1,200 restatements filed in 2005. As I read these rules, in the CD&A there's no requirement that a company list its policy with respect to clawing back. I think that's a mistake in omission. If you read it, it talks about things you have to -- you have to describe what you're going to pay. And there's no requirement that you describe ways in which you might get that paid back in. And I think if there was a requirement consistent with Sarbanes-Oxley, that you have to describe your compensation

policy with respect to clawing back, sort of mispaid compensation, it would cause companies to think harder about their obligations under Sarbanes-Oxley.

Dan Siciliano: Great. Well, with that, we'll try opening it to questions, and if there aren't any questions, we can prime the pump with a handful. But are there any questions right off the bat, out of the box? All right. Well let me ask the "prime the pump" question number one. We have, like, four of these in reserve. Hopefully that'll get you going. First, one way, arguably, to induce change, is to educate board members, and this exercise might, as the rules are stated, arguably be an education process for the board members. We've heard some proposals about creating connectedness with the board members and the various outcomes of this approach, but I'm wondering, from each of the panelists, do you think boards will be, A, surprised by the results of these numbers, what will be the reaction of that surprise, and what's the practical outcome, whether an unintended consequence that you'd like to speculate on or the result, which I think some people would want, which is if in fact they are surprised -- and they're surprised to the, oh, my gosh, that's a much bigger number than I thought, we need to behave to remedy that -- do you think that will really happen? So maybe thoughts on board reaction if we went through this exercise as stated?

Adam Chinn: As a lawyer, it has always been my understanding that the business judgment of directors was the domain of the corporate laws of the states in which the company was incorporated and not the federal

securities laws. And although I agree with you that basically both Sarbanes-Oxley, the executive comp rules, has basically caused these so-called disclosure rules to be substantive corporate governance requirements. And the reason for that is what directors are most concerned about, and I will take issue with Greg here, is not whether or not their stock options are going to get accelerated if there's a deal, because a lot of these directors are independently wealthy anyway, but is not getting sued. And, frankly, that has become the number one concern in the boardrooms of America is that the disclosure rules, a certain amount of activism has done nothing but create a wedge between management and boards of directors.

I think if you did a study of some of the largest corporations, you would find out that the costs for increased compliance with Sarbanes-Oxley, some companies I know have had their D&O policies go up 1000 percent in the last five years -- makes the numbers that we're going to be disclosing here pale by comparison. And what's going to happen is there's just going to be many more consultants, I think, in the long run. Thank God the system of capitalism is a strong one, and people will ultimately do because most boards of directors -- there are outliers, but most boards of directors actually want to make good business decisions, which they believe will be in the best interest of the shareholders. Sometimes they're wrong, but what this is going to result in is sort of prophylactic device, and my guess is, just like the golden parachute rules, which actually had the opposite effect, everyone putting gross-ups rather than reducing severance, the

disclosure rules in the long run will not have a huge impact on what substantively happens.

There's going to be a lot of shock next year. There'll be huge articles written by the usual suspects in the usual newspapers, making compensation a moral issue, which, in my view, it's not. And then people get used to reading these numbers and shareholders, if they want to vote the bums out every year, they get a chance to do so. If they don't like deals, thanks to the SEC, you get to vote on a merger proxy, and you can say no, we don't think this is a good deal. But I don't think it's going to change, and I think the idea that there should be this line item veto about things that shareholders would like to cherry pick directors' decision making on is a proverbial slippery slope.

Dan Siciliano: It's so hard to provoke strong opinions on the panel. It's very depressing. Tom and Greg? Any thoughts?

Tom Kelly: Well, I do think there will be some moments of surprise, but not necessarily the holy cow moments you hear about in the press. I do think there will be those too, though. One thing I've seen [in an exercise in the] last year is just getting an understanding of how the excise tax law applies in such, what appears to be, an arbitrary and unfair manner. For example, you have two very similar executives, but one's been exercising their options and therefore building up their W2 wage base, may end up not having a benefit amount that exceeds the golden parachute tax. Whereas the executive who was doing the right

thing, holding onto their equity, not exercising early, ends up owing a lot of money in excise tax, and therefore gets grossed up. I know in one client, they only provide a gross-up protection to about a half dozen people, and our exercise identified about 30 that could be subject to the excise tax. And that asks the questions of not should we get rid of the excise tax gross-up protection, should we extend it to more people? Because it does seem to be unfair.

The other one I've seen, just as an example, that got a lot of us scratching our head was a provision to guarantee medical coverage after retirement. Again, it doesn't -- they provide it to people who reach a certain age in service, but in a transaction, we had to get some actuaries from another firm to give us a number on it, and the dollar amount of that seemingly innocuous benefit shocked everyone, just because of the way the tax rules of how we had to value it. So I do think there'll be some surprises. I think there'll be, as I referred to in my remarks, not just the dollar amounts that get put down there, but just the discussion about the provisions that will take place in some of these comp committees and boards. It's one of the reasons we think there's going to be a lot of change in this area going forward. But it's hard to take away benefits you promise to people today. We're already seeing companies talk about we're going to change this, but it's only going to take effect for contracts or renewals going forward, not going retroactive.

Greg Taxin: I believe the effect of the rules as written will be to raise compensation steadily over the next decade or two. I do believe what was discussed

earlier, that basically it's very easy to look down the street at your peer and say, well, he has a driver and home security and I don't, and I'm equally vulnerable to car accidents and burglars. And so it's always easy to point to the things that you don't have, which sort of creates a one-way ratchet and a competition between them. I think that will be the effect. I don't know if that's good or bad. My view is that people ought to be paid in line with performance, so I guess maybe I'm saying that's probably bad, if there's a general increasing in the averages. That's why I think we need a listing requirement around voting on the CD&A disclosure and approval -- sort of a place for shareholders to express their point of view about the compensation practices at the company, an advisory vote, essentially, that creates a locus of opinion making and decision making around compensation.

Last week was the Council of Institutional Investor conference, and they all sit around wringing their hands about excessive amounts of compensation. I think the problems they have are only partially solved here. The first problem is just identifying the amount of compensation and the incentive structures that have been put in place, that is largely, I think, cured and solved with these proposed rules. But the second problem, which is actually worse, which is, okay, so once we conclude that some board has overpaid their executives or is misaligning the incentives or is the 1 in 1,000 boards that seem to be incompetent in setting compensation for executives, now what do we do? There's no place for them to consistently express displeasure with the way the company has decided to set compensation arrangements. So it's not a line item veto, I don't think, Adam, it's a desire for shareholders to be

able to stand up and express their view in one spot, in one place, in a focused vote. The other thing I'd say about --

Adam Chinn: Let me just ask this question. For pharmaceutical companies, then, should shareholders get to vote on the R&D budget? Or investment banks on the hiring policy? At what point do you say, look, there is a system of corporate governance in this country, which you may not like, but, you know, boards of directors by corporate law get to exercise their business judgment and make decisions? It's a representative form of government.

Greg Taxin: Well, that's not true, Adam. It's not representative. They don't represent anybody. They don't get elected by anybody.

Adam Chinn: Yeah, they do get elected. The directors get elected every year. I know you haven't been practicing law for a while, but every year there's an annual meeting, and the shareholders get to vote on the directors, and there are proxy fights where directors fail to get elected. This is not the Supreme Court. This is not life tenure. Every year the shareholders get a shot at saying we don't like what you're doing.

Dan Siciliano: And the elected versus not elected. That's a whole different forum, which I'm sure we'll host again some day soon.

Greg Taxin: I do think, Adam, that my basic answer -- and I think it's a fair question -- about why this matters and shareholders shouldn’t have a vote on R&D budgets is really two things. First is this is self-dealing in

the sense that it is paying yourself directly, in the case of boards that are paying themselves, or close to that, in the sense that you're paying management, which has a role in both running the company and setting strategies as well as in the compensation process. So it is unlike deciding what building to rent or lease and much closer to a related party transaction where total fairness should be required, and it's good to have oversight of people. So that's point one, I guess. And point two is it directly relates to the strategy of the business and the incentive structure for moving the business in one direction or another. And that ultimately is something that shareowners deserve information on and there tough to be a feedback loop on as well. And this is the best way to provide a feedback loop without it being a binding vote that affects the way the business actually operates.

Dan Siciliano: And the moderator is saved by a question from the audience.

Male Voice: Going in a different direction, I'd like to hear what Greg and Adam have to say about the observation I made before, about the number of companies, large companies that file 8Ks reporting exits and retirements and don't report the numbers.

Adam Chinn: Whether it's a good thing or a bad thing?

Male Voice: No. In my view, under the current rules, they should be reporting, and there doesn't seem to be any serious enforcement effort. I wanted to know what your levels of concern are. It seems to me that when the big guy goes out, there ought to be a tally sheet that says what the big

guy got. And that should not be descriptive, narrative. It should also be dollars and cents. Adam, this is your clients, and Greg, these are companies that you guys watch. I want to get a sense of how you feel about companies that basically flaunt the 8K requirement.

Dan Siciliano: Just to be fair, I'm going to have Greg go first and Adam go second this time around.

Greg Taxin: Great. I think more disclosure is better than less disclosure, so that's an easy principle. These new 8K requirements I think actually are going to take the burden off of companies. As I read it, it calls for a "brief description" of the arrangements. So whatever argument you may have today, I think you end up with less of an argument after these rules, that all those things need to be disclosed in an 8K. The other thing I'd say about it is once the big guy goes out the door, the big guy's gone and so is the money. I'm not sure that point is the best moment to find out about all this stuff. It tells you something about the board, but it's a little bit late at that point.

Adam Chinn: I think once these new rules are in place, I agree, all of this stuff is going to be there on the table for you to do the math. I think the practices, at least in my --

Greg Taxin: We both know that that's not true, so you know, because it will [be the math and one-point proxy] --

Adam Chinn: Right. Well that's sort of my point on the gross-up, so I have to agree with you there. I think the current practice, and there may be some people that don't do it, but at least in my experience -- it used to be that no one would put the numbers in an 8K. I think the trend has been towards doing so. Maybe not everyone does it. I don't want to accuse potential clients of mine, of flaunting 8K rules. But I think the movement will be, as time goes on, that you will see more and more numerical disclosure in 8Ks.

Nell Minow: First I want to say that I don't think it's such a bad thing to drive a little bit of a wedge between the board of directors and the management. It's been such a cozy relationship, with their arms sort of flung around each other, that it's nice if they get as far away as arm's length. And I think right now there's a great wedge between the shareholders and the directors, and whether we talk about whether it qualifies as an election or not, the fact is that in 99.9 percent of the cases, they are nominated by management and no one runs against them, so it's not exactly a very robust contest. The question that I have for you is that, as we're dealing with post employment payments, I wonder if you all would make a distinction between being terminated, retiring, or leaving with regard to a change in control, about how the board should handle those, how they should compensate for those, and how they should disclose what they're thinking is for all categories.

Tom Kelly: Well I do think that there's different scenarios relating to termination that need to come into play. One of the bigger ones we've seen written into agreements now -- it used to be just termination for cause and

termination without cause. And now there's this new category emerging, which is termination related to performance, not necessarily for cause, but the performance of the company -- the executive wasn't good -- and I'm not a lawyer. I don’t know how you write in that specific language to get it the way you want, but we are starting to see boards look at not just, again, the provisions of a contracted term sheet, but trying to go through what I call the imagination exercise. Let's imagine what could happen and what the outcomes might be. And with the tools available, running the numbers -- they're estimates, as Adam said, they're projections.

One thing I would say to the SEC is that it would be very difficult to prescribe the assumptions on all the scenarios that would need to be put in place for every company to make this meaningful without using up a lot of paper. In most boards we work with, we do use some assumptions. We go through the different scenarios. We talk to other experts to get an idea of what some of these provisions might cost if this happens in the future. One of my favorites is a promise to pay life insurance for someone. I have no idea what that's going to cost, each executive, if this happens three or four years from now. Certainly share price issues come into place for both the value of the equity that accelerates as well as the impact on any gross-up payment.

So I do think what we're seeing is boards looking at the scenarios, trying to categorize them, and distinguish between do we like this outcome, when we run the numbers. That wasn't happening that much two or three years ago, and it's leading the dialogue. Where it ends up,

a little too early to say. It's a challenge for most boards, though, to look at those numbers and not ask those questions about is this what we really want to happen?

Dan Siciliano: Let me jump in and actually build a little bit on Nell's question to elicit more reaction. That is, a particular scenario in which you have termination without cause, and you have a board, at least from a neutral-third-party observer's viewpoint, step outside the provisions of the contract and give termination payments that exceed what seemed to be the parameters of the contract. Now they do so in exchange for valuable consideration of various sorts, nondisparagement, et cetera, et cetera. My question is, does anything in the rules, as proposed, create what you might argue is a precommitment strategy on the part of the board to strategically address these points of termination without cause, consideration, in advance, because without getting into the technicalities of the employment contract, we all know that that is relatively doable, right? I mean, you can say you're not going to get this severance payment unless you have also simultaneously signed the following waivers as described reasonably so on the attached Appendix A, B, and C in the following forms.

And if you do that in advance, in the executive contract upfront, then, in a way, you strengthen -- I won't say make perfect -- the boundaries and the ability for the board to end the relationship within that boundary -- and without naming names, I think it is those circumstances where executives walk away, terminated without cause, to spend more time with family, where people look at the contract

afterwards and say, wait a minute, if you add it all up, worse case this was $11 million, and the check was $22 million. What was the $11 million extra for? And there's lots of explanation. So my question is does anything in the rule at this point, do you think, address this -- what can be named precommitment issue on the part of the board not to exceed the bounds of the contract, well-structured employment contract -- I don't know what it is, but, Greg, Tom, Adam, what do you think?

Adam Chinn: I hope there's nothing in a disclosure rule that prohibits a board of directors from using its business judgment to react to circumstances that it has to deal with in real time, and I would be surprised if anyone thought these disclosure rules were intended or could, as a matter of law, do that. That would be my --

Dan Siciliano: Do you think that there's any way for an investor, though, to discern whether a board is more likely than not to pay out above and beyond the available tabulated costs, when the time --

Adam Chinn: I guess it's sort of stop me before I kill again. Maybe if they've done it once, they may do it again, but the question I would ask to all of this is, to what end? Maybe to Greg -- what is it that the shareholders are looking for other than lots of information, which I agree information is usually a good thing, although sometimes misleading. The question that I often ask myself is, look, this is all very interesting, and it makes exciting reading on the business page and now on the front page of some of our nation's greatest newspapers, but to what end?

Dan Siciliano: You're now obligated to respond, Greg.

Greg Taxin: You're just staring at me. No, I agree with Adam. I don't think there's anything in these rules, which will affect the practice of a board making a decision in real time, that somebody deserves more than what they may be obliged to receive.

Dan Siciliano: Putting you on the spot -- you can decline to answer -- would you agree it's a best practice to structure employment contracts that predetermine the most likely anticipated necessary waivers, so you don't have to negotiate post hoc, when the time comes?

Greg Taxin: Yeah, it's probably a best practice, but it won't be a universal practice. It's not a horrible thing if it doesn't happen.

Dan Siciliano: Is there any clever idea to disclose whether or not that best practice is followed?

Greg Taxin: I don't think so.

Adam Chinn: In some cases people try to have the best of both worlds. They say, look, senior executives shouldn’t have employment agreements, and then, because they don't have employment agreements, when they get fired, you work out a severance for them, you say well they weren't entitled to that. It's one way or the other. If you want people to have employment agreements that set forth their severance, you can do that.

It's going to leave the board with a lot less flexibility when the time comes. Or if you don't want them to have the employment agreements, then people are going to work out severance arrangements that they believe are reasonable, given the industries that people work in.

Dan Siciliano: I was just trying to keep it interesting until Joe finished his --

Adam Chinn: No, it's really good.

Joe Grundfest: Well, you know, earlier on, Adam, you made a point that I think really should evoke the sympathy of everybody in the room, and that is the rules, if adopted --

[Break in recorded material.]

Joe Grundfest: In order to describe what the actual effect of the change-in-control provision is, you need to know the parameters of the change-in-control. So when will the people be taken over? At what prices will the takeover actually happen? What situation will the CEO be in at that time? What age will the CEO be and all that other sort of stuff? That gives rise to many problems. First, the companies that have to comply with these rules can, in good faith, have problems complying. What's the right estimate? Second, when life comes to pass and the situation is different than what's estimated, that can give rise to frustrated expectations. Third is an opportunity for tremendous non-comparability among companies. You could have two companies with exactly identical change-in-control provisions disclose very different

numbers because they make different assumptions about how the change in control is actually going to happen. Would the rules be better if they were amended to provide benchmark assumptions that every registrant must comply with.

So, in other words, when articulating the change-in-control provision, assume that the takeover occurred as of the end of the last fiscal year, where the CEO and everybody else had the same age and all of the other conditions that you would have found as of the end of the last fiscal year, and that the transaction occurred at the arbitrary premium of 20 percent to the 30-day average price observed, as of the end of the last fiscal year. Additional assumptions might be necessary for termination provisions, retirement, and the like, but would the rules work better if we had benchmarks that would create comparability along those lines and then allow every company, if they wanted to disclose different assumptions, supplement with those disclosures as well?

Adam Chinn: I think, Joe, it depends. Do you want disclosure to be accurate or do you want it to be mechanical? You could have a situation where you disclose this and six months later you had a change in control and the actual numbers were materially different. And that's, once again, what information are you trying to give your shareholders? If you want to know what someone's compensation is, how many options they have, what the strike price is, whether or not they accelerate, all of that I think absolutely is objective knowledge. And it's particularly sophisticated institutional investors who have got someone who can

run an Excel spreadsheet of various assumptions and know that, in order to work out a gross-up, it's the excess tax payments multiplied by .2/(1 minus the tax rate). If a lawyer knows that, an institutional investor can work that out.

So I just think that what we're doing here is potentially putting what is going to be misleading information into the marketplace and may have less sophisticated investors making assumptions as to what's going to happen upon a change in control when that may not be what happens. There may not be a 20 percent premium. It may be a merger of equals. Or it may be the greatest deal of all time and someone pays a 50 percent premium. I just ask the question is it really getting people a lot more information that they can usefully use, or is it ultimately going to be misleading and lead to -- I could write the shareholder suits, which may ultimately get dismissed, but this is just going to be fodder for the plaintiff's bar.

Tom Kelly: I think that, certainly, when we do these exercises for boards, we use tabular exhibits, and we develop a series of assumptions to use to make the analysis results meaningful to the board. The question is should the SEC prescribe what those assumptions should be. And these arrangements are very complex, and they vary widely from company to company, so I'm not even sure that comparability should be an objective of these types of analyses. In fact, across companies is one thing. Each time we run these analyses for some of our clients -- they change daily if we ran it every day. I think, generally, I hope that when companies do this, they would follow the example set by Pfizer,

where they set some very specific assumptions, disclosed them, and put together a nice table that breaks out the elements in a way that investors understand, because you are telling a story with them. It would be difficult to read through a lot of narrative disclosure with a lot of footnotes if you went through every scenario. So to me the question becomes what can you prescribe versus what are reasonable assumptions for companies to use to develop these calculations.

Dan Siciliano: We have time for one last question.

Jeff Banner: Hi, Jeff Banner from Moody's Investor Service. I would just say, from the perspective of somebody that tries to get a handle on what incentivizes managers, just knowing what the impact of a change in control would have been the day before the proxy came out would give a lot of -- it doesn't need to be that forward-looking -- it would give you a lot more information than we currently have on knowing what might be going on in an executive's mind, as far as when they look at potential transactions. So from my perspective I think it doesn't need to be that forward-looking. Just tell me what they would have gotten yesterday.

Dan Siciliano: We have just time for maybe a one-minute wrap up from each of the panelists, and then we'll finish on time. And I'll start with just the one comment, which is I'm glad that Greg pointed out the XBRL as something that is desirable. We would be remiss as academics if we didn't point out that that would be really, really good, as well, from our end, just in terms of data gathering. And, quite frankly, in the context

of this discussion, a lot of this is manipulating data under given scenarios, so, you know, Monte Carlo simulations, for those of us who like doing this stuff, scenario analysis for those who don't, and hopefully outsourced work to some underling for those who really don't like doing this stuff, but the point is with more flexible data and retrievable format, it becomes easier to do, and the transaction costs for this go way down. And people like, Stanford can provide it at low or no cost to a wider group of people. And then the other high-end service providers can build on that and provide very valuable information. So that will be my one plug. Then I'll switch to Greg.

Greg Taxin: I obviously have to echo that. It's 2006. We should be able to get this data in a format that's actually useable, not just using the Internet as a fax machine, which sort of feels like what we're doing today. The only other point I'd want to reiterate is this event-driven bonus area. I think there is a series of incentives that certain managers have that would not be required to be disclosed under these rules and probably should be. I guess the third thing I would say, on Joe's approach, is I think any fixed set of assumptions will have unintended consequences. Companies will just structure their change-in-control arrangements around what they know to be the disclosure requirement. I think you'll have unintended consequences. I can't tell you which way they'll go, but I think it creates an artificial incentive in the marketplace that may end up creating suboptimal economic arrangements, to avoid or change disclosure.

Tom Kelly: I think to echo that, certainly we support the idea of enhanced disclosure in this area, getting more specific in detail. We are a little wary of trying to be too prescriptive with what that disclosure involves. We believe that most companies, though, regardless of disclosure requirements, are beginning to do the exercises required to get a sense of what these obligations are and reevaluate the provisions. So we do think it will help drive a lot of change in this area. We're just wary of being too prescriptive of, here are the assumptions, here are the things you have to include.

Adam Chinn: I agree with both gentlemen. I think rules influence behavior but rarely in the manner that you intend them to. And the experience with, especially in the area of compensation -- and we've had some experience, 280G, 162M, which was Congress trying to limit nonperformance-based compensation to $1 million -- market forces, in the end, tend to win. And rules that attempt to proscribe behavior that the market, for whatever reason, tends to encourage, tend to have the results opposite to those intended.

Dan Siciliano: Well, with that we'll be switching straight to the next panel, but help me thank this panel.

[Applause.]

Dan Siciliano: Thanks, guys. That was great. Thank you so much. That was great.

Panel 4: Director Compensation and the Boardroom Response to Compensation Disclosure

Moderator: Joseph A. Grundfest, William A. Franke Professor of Law & Business, Stanford Law School

Panel: 1. Joseph Bachelder, Bachelder Law Firm
2. Matthew Bishop, Chief Business Writer, The Economist
3. Simon M. Lorne, Vice Chairman, Millennium Partners, LP and former General Counsel of the SEC (1993-1996)

Joe Grundfest: Well thank you for hanging into our last session. This session is going to focus on the effects of the disclosure once this information hits the boardroom. Several other matters will come up as well. One thought that occurred to me, as I listened to the other panelists talking about the possibility that this disclosure will actually cause rather significant increases in executive compensation, is the possibility that these rules might turn out to be the most brilliant political maneuver in the modern history of the Republican party, because in the guise of democratizing shareholder access to information about incentives it could stimulate a dramatic increase in executive compensation across the board,. That is obviously not what people were thinking about or intending at the outset, but may turn out to be the consequence in this case. We have a fantastic closing panel over here. Let me just briefly introduce our panelists.

Sy Lorne is a former general counsel of the Securities and Exchange Commission. He has had a brilliant career as an attorney prior to being

general counsel, also sits on several public boards, and is currently vice chairman of Millennium Partners, in New York, one of the largest hedge funds around. Joe Bachelder will speak after Sy. Joe has been in the executive compensation business for decades, and I think it's fair to say probably has more intimate knowledge of how these arrangements are negotiated and what goes on in a boardroom than just about anybody you could run across. And Matthew Bishop, to my mind, is one of the most sober, intelligent, balanced, and literate commentators on the corporate governance scene of the United States. He can do that because he's from Britain, where they actually have mastered and invented the English language, and it's always a joy to read his writing. So with that, by the way of introduction, Sy, why don't you kick us off?

Simon Lorne: Joe, thanks. There are a few points I wanted to make. Then as I listened to today's discussion up to now, some additional points came up that I wanted to plug in, so there may be a little bit of tattered junctions from point to point, but bear with me. We've heard a couple of times today, from the Chairman and from the former Director of the Division, that these rules are about disclosure and not trying to influence behavior. That's one of those things I trust everybody understands that people in such positions are supposed to say, because the statute authorizes disclosure and periodically there is litigation, such as the current US Chamber of Commerce litigation that says the commission is using a statute designed for one thing to accomplish something else. And as people experienced in the area, and with experienced lawyers, they know what not to say in public, so that, of

course, they say the rules are about disclosure. And if you think for a minute or two, you realize that can't possibly be true.

If it's about disclosure, then it's about disclosure that affects individual or institutional investors, and when you think about the kind of information investors really think about on the specific compensation issue -- and I'll come back to what I mean by that -- they care about the total compensation. They don't care about the 30 different ways compensation may be broken down. And so I take it as given that in fact the rules are about more than just disclosure. As a citizen, I tend to agree with that. As a citizen, I tend to think we do have a significant issue involving executive compensation and the ratios of top-end executive compensation to average workers, et cetera, are numbers that I find disturbing, upsetting, and not good for society, as a whole. But that leads me into two different areas in which I have questions about the rules, I'll say, in general.

One is, is that really the business of the SEC, and is it the kind of thing that the SEC should try to regulate substantively through the disclosure mechanism? And I think there can be different views on that, but this is one that I would think is probably not the issue. The other, more important to my mind, is something Alan Beller said this morning that echoes back. Joe, I'm sure you'll recall something that Charlie Munger said at a breakfast at Directors' College five or six years ago, out at Stanford. Charlie Munger said, essentially, greed isn't the problem, envy is. And the disclosure mechanism is a very good way of addressing greed as a problem, because it provides for public

embarrassment, and it's the sort of thing people don't like. It's a lousy mechanism for addressing an envy problem.

The proposed rules, for example, Alan Beller suggested -- some think, and I tend to -- that by having one clear number, what you tend to encourage is competition to have a bigger number. I would suggest that the specific rules maybe get a little bit worse than that. If you count the different boxes in all the different tables, I counted 40 different boxes to be filled in, with consideration of another nine boxes. And my guess of the way envy works is you're going to have people out there saying they want the biggest number in every box. And I'm troubled by that, and I'm troubled by the kind of behavior it may address. I have serious reservations about whether the rules will have the sort of consequences I think are intended, although I join in the intent.

As you've listened today, we've heard two different discussions, and Katherine Schipper I think highlighted it quite well this morning, when she talked about disaggregation. You've had one discussion about compensation and another discussion about incentives. And the discussion, like the proposed rules, tends to take those two things and toss them up together like a salad so you can't tell which is which anymore, and I think it's sort of like a combined washer/dryer that doesn't work quite as well as a washer or quite as well as a dryer, and it muddles along. It seems to me that the compensation issue is what

do these people get paid last year, why did they get paid that, what were you trying to do with it?

It's a backward issue, the kind of issue the SEC sort of naturally gravitates toward. Incentive is purely a forward-looking issue, not an accounting issue. It's in the range of things the SEC over the last five or ten years has said it should be looking at but still doesn't do a very good job of thinking it through. I think both the incentive piece of it and the compensation piece of it are worth thinking about and worth disclosing, but I think you get very different answers and, trying to combine them, create sort of a mess.

Now there may be a third area, which is how do the incentives we thought we were setting up pan out? But that's different from the pure compensation issue. An example is the ways in which these are different. There was a discussion about whether the proper measure is the cost to the company or the benefit to the executive. Well, compensation is a question of cost to the company. For me as a shareholder, the compensation question is what do I no longer have because I gave it to the CEO? Incentive is a question of benefit to the executive. How is he or she going to be incented, what kind of actions can I expect? And that is neither relevant to what the cost to the company is, nor, by the way, is it relevant to a compensatory measure, necessarily.

The incentive for Warren Buffet who owns a third, plus or minus, of Berkshire Hathaway is exactly the same whether he owns a third

because he bought it 45 years ago or whether he owns a third because he acquired it through stock options that were exercised over the last 20 years. And indeed, some of the incentive questions have nothing to do with compensation. I think maybe it was John Core, somebody this morning, who pointed out the incentives inherent in out-of-the-money stock options. And quite naturally, from the historical SEC view of things, out-of-the-money stock options we don't worry about, but the incentive factor is very, very different, and it is something to be concerned about, and it does require disclosure. So if I were thinking how do these rules sensibly get rewritten, I would divide into two or maybe three pieces.

One is what was the actual compensation paid last year? And on that piece, by the way, I wouldn’t care at all about the options that were granted three years ago and exercised last year, because the compensatory part of those was when they were granted, not when they were exercised. And the exercised number -- it's nice, it's sexy. It gets us all excited the same way we get excited about the amount of money Barry Bonds or Oprah Winfrey gets, and we sort of have a prurient interest in seeing those things. It's good for selling copies of The Economist and that sort of thing, but it isn't terribly relevant to the compensation issue. And so I would tend not to provide information on that sort of thing. I think the separation of the truly legitimate disclosure issues from what I'll call the not so relevant disclosure issues, the separation of compensation from incentive, and I would echo the comments somebody made earlier that a danger in all of these is that the incentives don't turn out to work quite the way people

intended them to. There are unintended consequences that affect not only compensation committees but the SEC.

If the SEC adopts these rules as written, and if the concern is envy not greed, the SEC will have made the problem worse. That is not the intended consequence, but it could happen. In the same way, compensation committees try to set up incentives, try to think about how they work, may well be setting up a situation for unintended consequences. And I worry about that. And I worry about the disclosure along with it. I am not terribly fond of the newly proposed disclosure about the corporate governance elements of the ways in which the corporate board balanced conflicting interests in related party transactions, which seems to me, following a point maybe Adam made in the last session, seems to me to be setting up traditional state law issues for federal disclosure law litigation, for no particular reason. You may not like the way the Disney case came out in Delaware, but it was certainly a well-heard case, and it was thoroughly examined, and I don't see any reason to provide another venue in which those things can be litigated differently.

I think there is a mix of considerations. I guess the two last thoughts I'd mention -- one is I was a little bit concerned, as a director, thinking about the compensation disclosure analysis, only because this is not very much like the management's disclosure analysis. If you look at the way financial statements work and what goes on in a company, there are a lot of things that happen every year. There are a lot of ways in which those impact the balance sheet and the income statement.

There are a lot of things that properly should be talked about so that shareholders can better understand what's going on in the company. If you think about compensation disclosure analysis, the compensation committee is likely to have a philosophy and try to put that into effect. There may be, in some years, changes in the philosophy or new thoughts, but by and large, it isn't the sort of dynamic changing year-to-year thing that one sees in management's disclosure analysis.

The final thought I'd mention is simply that I find it sort of surprising, and maybe this is responsive to the media and the prurient interest piece, but if you look at the SEC release in this area, which in its original form is something like 350 pages, it gets boiled down in the federal register through single space and small type and columns to about 95 pages. If you sort of match up the length of the release with the length of releases on other topics, I think you'll come to the conclusion that compensation is getting relatively more attention than it deserves in relation to the corporation as a whole.

Joe Grundfest: Joe, what does the situation look like from your perspective, as somebody who's worked with many boards on these issues?

Joseph Bachelder: Well I think that the SEC has done for directors' compensation, which I will focus on here, what Teddy Kennedy has been trying to do for years for the minimum wage. I'd like to speak for just a moment -- I'm old enough, I've earned it, for 60 seconds -- on the subject of compensation as a pricing mechanism. If you buy or sell a share of stock or buy or sell a house or a commodity, you have an active seller's

market and an active buyer's market. Now, when it comes to compensation, and compensation of directors in particular, it has a characteristic that I might call pricing chasing pricing. It is not the same as if we were going to turn around and, tomorrow or next year or several years from now, sell a director or sell a CEO. We're trying to establish what is a reasonable pricing mechanism for directors.

Looking at that particular point, which is my topic primarily for the next few minutes, I think that having a total compensation column is a marvelous way of getting attention. Now the media will have a field day. Who will be the first ones that will have a total compensation of their directors of over $1 million? It was not that many years or decades ago when CEO pay broke $1 million. Now we'll find that the total compensation of directors will break $1 million. What about a chairman of an audit committee or a chairman of a compensation committee, learning what that chairman makes at another company? Pretty soon you're going to have boards of directors, and again some of these principles may apply equally well on the executive side, but I'm just addressing the director situation for a moment.

What kind of effect will discovery have in a much broadened landscape of director compensation on those hardest working among directors, which are chairmen of audit committees and chairmen of compensation committees. At the very least, they ought to be at the medium, and when that happens, we know what that does to the medium. So I think we're going to find that the ratcheting effect that we have been wringing our hands over, with regard to executive pay,

is going to apply in spades with regard to directors' compensation, which already has been growing over the past several years, since 2000, at a double-digit rate. We will probably find it's going to go up even faster.

I have some questions with regard to the director's compensation table, if I might just take a couple minutes. In an era when it is difficult to attract new directors, what effect will this have on the pricing of directors? And there's something different between a board of directors and a CEO. There are 8 or 10 or 12 of them. You can fire a CEO. You can't fire a board of directors. So as you disclose compensation in greater detail and you make the role of director become more akin to that of executives, by having an equivalent table, aren't we perhaps overemphasizing as the point was made a moment ago, the role of compensation in a part of our corporate governance. We're presenting it as if there's a total compensation column for executives and a total compensation column for directors.

Now, think of that for a moment. I'm a chairman of a compensation committee or an audit committee, and let's say I'm shown right there. I put in 200 hours a year. And I'm paid $200,000. I'm getting paid $1,000 an hour. There it is. Right there in the total compensation column. Now let's compare that with the total column for the chief executive -- suppose the chief executive officer is earning $10 million. Now, suppose that he or she is putting in 2,500 or 3,000 hours a year. What sort of impact will this have on the pricing, again, of directors? What should directors be paid for an hour? Which raises an interesting

question: why don't we have a budget for directors? Why don't we have some sort of an idea each year as to what's expected in terms of director contribution? There's one thing about a CEO: if he or she is doing their job, there's probably going to be no more time left in their day. At least generally speaking. But directors, 200 hours a year, that's not too far off, for a general number. Now, in Company A are they at 100, at Company B are they 300, that would be an interesting statistic to have. Wouldn't it be interesting to be able to divide that number into that compensation that we're paying for?

Just a couple of other things. Why is it that there is only one year of disclosure? I raised that point earlier. I think that three years of disclosure makes sense because how can you really tell -- you've got changed board members and other things going on over a three-year period. In fact, why don't we show, with a compensation table, the turnover of the board over that same period of time. Wouldn't it be interesting to see whether the compensation committee last year was the same as the compensation committee the year before, the year before that. Three years of data I think would make sense.

And then, finally, I think that, in regard to the narrative that's proposed, in connection with the directors' compensation table, it might make sense to have the same sort of explanation as to, specifically, why are the directors' compensation the way they are. What are the components and why do we use these components? Acknowledging that it's going to be very difficult to have pay for performance, when it comes to directors, because you do not generally

pay 125 percent extra incentive for extra good faith performance. I'm being facetious, but it would be of interest to know on what basis the compensation committee and the board is compensating itself.

Joe Grundfest: That's actually quite an interesting conversation because if you look at this entire market there's a perspective from which director compensation is perhaps the toughest issue of all, because in the market for CEOs, you have situations where companies have to go out and actually try to hire a new CEO. And there's competitive bidding, and there's a price that you find in the marketplace. However, when director compensation is set, there's really no market of that sort. In effect, directors set the compensation for themselves. CEOs are supposed to negotiate the compensation with the board of directors, so as weak as you think the governing mechanism is, vis-à-vis the CEO board relationship, you don't even have many of the same governing factors in the relationship when the board has to determine its own compensation.

Simon Lorne: Joe, do we think director compensation to date has been a problem? Certainly the release suggests it is an emerging issue. I don't have that sense, but I could well be wrong.

Joseph Bachelder: I think that it is reflecting in its increase year after year. Certainly, as in Sarbanes-Oxley, the increasing load on some directors. I don't know that, today, it's a problem. It's a lockstep form of compensation. It's more systemic than it is individual, in the case of CEO and other senior management pay. I don’t think it's a problem today, but I do

think that five or ten years from now it will be very interesting to see what those levels are. And what the multiple is for a director's time for 200 hours a year compared to an entry-level employee who's spending 2,000 hours a year.

Joe Grundfest: Well we'll return to those issues. I'd be fascinated to hear about Matthew's perspective on some of these issues.

Matthew Bishop: Joe, thank you for asking me along. It's been a fascinating discussion. You really asked me to look at the media role in what the boardroom response to all of this will be. This is a practitioner/academic conference, so I thought that as a practitioner I would look at the academic economic literature about the role of the media, which turns out to be astonishingly thin. Really the classic paper was by Michael Jenson of Harvard Business School in 1976. He starts by quoting the newspaperman H. L. Mencken. To this effect, the average American newspaper, especially of the so-called "better sort," has “the intelligence of a Baptist evangelist, the courage of a rat, the fairness of a prohibitionist boob bumper, the information of a high school janitor, the taste of a designer of celluloid valentines, and the honor of a police station lawyer”.

And the paper goes on in similar vein, really. It's sort of basically looks at the media as an industry and says it's primarily motivated by selling entertainment to an audience that's basically not interested in getting information. It's interested in getting entertainment. As such, there's a tremendous need to provide drama, a lack of ambiguity, very

much a focus on individuals as characters in this drama. And Jenson coined something he calls "devil theory," which is basically that there can be no complex motivations. Bad things are done by bad people, good things are done by good people, and never the twain shall meet.

Happily, he does reject conspiracy theory, the idea that newspapers are controlled by a group of people who want to run the world. He also rejects ignorance theory, that is that we're all stupid, us journalists. And finally he rejects the notion that the industry is essentially driven by bias, which rules out the view that because journalists are so poorly paid, they're just jealous of all these well-paid chief executives, which of course nothing could be further from the truth.

The other great paper in the area -- all the work that's been done by Alexander Daincourt and Louis & Garlez, which is much more recent. Now, they buy some of the Jenson analysis. There are all these complex motivations and influences on the industry. But then they do think there is a role in providing information that the media plays. However, they generally note, again, in economics and in theories of how the market works, how corporate governance works, the lack of any theory of information. So I'll just read from their paper: “The process of diffusion of information plays a small role in economic models. Agents are assumed to be informed or not. If not, sometimes they're given the option of acquiring information at a prespecified cost. There is no role for information aggregators, which selectively reduce the cost of acquiring information.” In the real world, the media play this role. People obtain much of their information from the media,

which play an important part in selecting which pieces of information to communicate to the public and in adding credibility to information provided through other sources.

Now, I think there are two very important things they mentioned there. Obviously one is selectively. And they go through a number of discussions about how it is that the media selects which information it's going to give and communicate to the public. And it talks about the incentives facing media firms and facing individual journalists, as they enter into a different quid pro arrangements for getting their information. And they have their own reputation to manage. It looks at the competitive market structure of the industry. The more competitive the industry, the more likely it is to do a good job in communicating information. And they look at things like ownership structure, where the role of advertisers can obviously play a role in influencing the choice of material. And then they look at reputation. Here they see a big role for the media, in terms of its ability to influence the reputation of players in the economic system in three different ways.

Firstly the role of politicians. The media can make or break a politician by highlighting the politician's failure to act, to deal with particular problems. So I guess we might look at Sarbanes-Oxley as an example of where the media clearly played a role in driving through legislation that may have been done in a hurry, without sufficient thought. Secondly, looks at the reputation of corporate executives for competence. From a shareholder perspective, i.e., are they good custodians of the shareholders' assets. And, thirdly, the reputation of

executives from the perspective of society as a whole, which may actually, they note -- which I think is a very important point -- the focus on the reputation that an executive has in society is one where the media has a huge role to play in sort of shaming corporate executives. On the other hand, the interest of society, the social norms in society, may not actually coincide with the judgment the shareholder would have of what a good performance by an executive would be. So you could actually pressurize executives to behave in ways that are not in the interest of shareholders in order that they could avoid social shame.

And then finally we have some work by John Core and others that actually looks at how the press has reported executive compensation and what impact that's had. Broadly negative coverage of executive pay in the media is more closely related to some notion of excess pay than it is to absolute levels of pay. On the other hand, the media tends to be quite selective on which companies it focuses, on bigger companies and on poorly performing companies, even when the excess pay problem may be greater at other companies. Finally, and not terribly encouragingly for those of us in the media that would like to affect the world, they find that it doesn't really have much impact on the behavior of companies, whether they get reported for having negative pay issues or not.

I just want to reflect very briefly on that analysis. First it seems to be the role of the media in the corporate governance system and the economic system as a whole obviously needs a lot more work, a lot

more study by academics. But it does seem to me that they do make a fair point in saying that the role is not unambiguously good, that the media has. Journalists do, in my experience, care a lot about the truth and about getting to the heart of a story. But I think none of us would deny that we face many incentives and pressures, or at least our organizations do, that do make us selective and care more about certain stories at certain times than we do the same story at other times, and that some information does get excluded. Often I think the media has done a very bad job of covering business issues in particular. One only needs to look at the cheerleading that went on during the bubble years, as an example of some of the failures. I think from a pure supply and demand point of view, cutting the cost of gathering and arranging, in order of rank, compensation information and putting it into one simple number will mean it will get published and widely disseminated, and journalists will be terribly shocked by the enormous amounts of money that have been paid to all these chief executives and so forth.

This is a classic Jenson story. It plays completely to our notions that simple black-and-white views of people, drama, characters that we can all put faces to, so it will be a great media story. Will it be good for governance? I worry that there's a tendency to sensationalize. In Britain, we had this great story of Cedric the Pig, who was our first real experience of executive pay being too high. The head of British Gas, which had just been privatized, was being paid about $300,000 a year. And the public was outraged. The unions -- his name was Cedric

-- the unions found a pig, called it Cedric, and unleashed it into the annual general meeting. He had to resign shortly afterwards.

Joe Grundfest: Which? The pig or the CEO?

Matthew Bishop: The pig had a fantastic career attending other annual corporate meetings.

[Laughter.]

Matthew Bishop: Is all high pay bad or is it pay for performance? I think the media is not very good, generally, at differentiating between outrage at high pay in absolute terms and making subtle judgments about the relationship between pay and performance. I certainly know The Economist -- that even us -- we do try and focus on the performance issue. It's just terribly tempting to throw the stock options number in with the annual base salary number and just come up with some aggregate number that sounds very large, even though we probably, on reflection, would say, well, that stock-based thing should be spread over several years or even taken in a much earlier year. It just looks somehow more enticing on the page, when you see those numbers there. I do worry that, in that sense, the failure to focus on performance will lead to quite a bad outcome, because the media is just not very good at knowing what to say there. And I do worry that we will focus on executive pay to the detriment of some other issues. I am very much of the view that excessive compensation is a symptom of an underlying failure of corporate governance, and that by focusing on the outrageous

numbers, we will ignore issues like board access and the uselessness of many institutional shareholders in failing to do their job as owners, properly. Because that's much harder to --

[End tape 3 / begin tape 4.]

Matthew Bishop: I'm hoping that there will be more communication between chairs of compensation committees, for example, and the media. At the moment I think all media communications tend to be done through one particular executive, the chief executive, and the idea that you can actually interview members of the board, such as the compensation committee chair, and get their reasoning explained in more detail than they do in the printed analysis, that will be something that I think newspapers will demand. Whether we will get it I think is uncertain. But these characters are going to become political characters, as well, as governance activists target compensation committee chairs. And so that will, again, provide more drama and keep this story rolling along in the press.

A couple of other very brief points. I do also think, though, this story will become boring to the press, at some point, so it's good news to executives, who can wait for a few years and then push through some new arrangements when we're not looking. Compensation doesn't always sell. I noticed there's been a falloff of recent sales of recent covers with pigs on the front and large sums of money mentioned to them. And there will be times like the bubble when we don't want to

write negative stories about company bosses. Those times will come again, I'm sure.

Known unknowns. The new media is clearly affecting the economics of the old media in ways that are likely to make the old media more and more sensitive to advertising pressure. That may encourage the trend to not report on some of these numbers in a hostile way. Blogs are going to lead to a growing focus on what journalists are writing in the mainstream media, that may expose when they don't think it through properly and they don't write well. There's a very interesting campaign against Gretchen Morgenson going on, on one or the two blogs that I'm reading, on corporate pay, at the moment, which are very interesting.

I also wonder whether the more we write about it the more private equity will provide a solution to the executives who are worried about being shamed into behaving more prudently. I wonder if Sarb-Ox is capable of making people consider going private, maybe being shamed at the country club, is going to encourage that rush from the public markets to the private markets even more.

My closing thought: will this actually lead to improved corporate governance, pay that more closely relates reward to performance? I'm not entirely optimistic, but if it doesn't happen, I don't think it's because the rule is bad. I don't think it's because the prurience of the press. I think it will be because the institutions who really should be acting on behalf of the ultimate shareholders, the public, that

Christopher Cox talked about earlier, are not really doing their job properly, as trustees, fiduciaries. And I wonder how, as the media, we could be doing a better job really reporting on that part of the governance equation rather than on the symptom, which is executive pay.

Joe Grundfest: It's fascinating. I don't know about you, but I was fascinated by this discussion because I'm sort of sitting here, and find the analysis quite sobering. To my mind, it points out that we're heading to a new environment in which this market is going to be subject to a new set of equilibrium forces, and you can tell a variety of stories as to whether these forces will cause executive compensation to ratchet up or whether they'll cause compensation to come down. And there are alternative mechanisms of action at work. There are two main mechanisms of action that might cause executive wages to stabilize. First, will shareholders finally step to the plate and exercise the power that they have under existing principles of corporate governance by, for example, withholding votes for the election of members of compensation committees where the shareholders have determined that the pay for performance structure is broken.

To me, this situation’s been frustrating for years. I actually wrote an article about this 12 years ago, now, about how shareholders do have a remarkable ability to discipline directors by simply withholding votes under existing corporate law. And it doesn't take access to the ballot or many of these other large changes, like majority vote or what have you, to really effect some important change within the corporate

environment. Yet, remarkably, institutional shareholders have not taken advantage of the authority that they already have, and to me the fascinating question is will they step to the plate on this issue of compensation? Given the history, there's little reason to believe that they will all of a sudden wake up and act intelligently and in their own best interest, but if you do believe that this information is going to moderate executive compensation pay, that may be your best hope. That might be why you shouldn't be too optimistic about it.

The second moderating force, as a mechanism of action, would be the notion that the press can induce shame or embarrassment. By winding up as a member of the compensation committee or as the executive that has your face plastered on the cover of a magazine, or what have you, you will be sufficiently embarrassed that you won't want to be there. Therefore, you will moderate your own conduct. Personally my guess is that many CEOs would be happy to take the extra $50 million that it takes to survive that shame. They'll have a rough two weeks in the press and then people will move on. So in the battle between shame and envy, envy lasts longer. Shame goes away. The half-life of shame is relatively short, and the executive has the extra $50 million to help salve his conscience.

On the other hand, if you look at the equilibrium forces on the other side of the equation, you've got this notion of envy. If another executive is making so much more money, then the first executive can ask "why shouldn't I also be making that much more money?" And, if as Sy suggests, you engage in the comparison category by category,

and not simply gross number by gross number, then the gross numbers will on a going-forward basis be even larger than they were before, because now you'll know about the retirement benefits, the change-in-control provisions, all that other sort of stuff.

So, to the extent that the ratcheting equilibrium mechanism isn't changed, I think Sy's view of the world is we might find the compensation inflation process at work on steroids. If, at the same time, this happens when boards continue to be weak, in terms of their monitoring function, because the shareholders aren't stepping to the plate, we might find this remarkably ironic situation where a set of disclosures that I think have to be made, and that many people wished and hoped would lead to moderation in this area of executive compensation, will wind up, at the end of the day, really having precisely the opposite effect. Joe?

Joseph Bachelder: I think, Joe, first, that the shock and awe that may accompany the total column, if it does go through, will recede. We've accepted so much in the way of increase of executive pay over the past decade, I don't think this column is going to make a dramatic difference in foreseeable future. Second, I would note what I call the Jack Welch principle, and that is that while Jack Welch was chief executive officer of General Electric, for approximately 20 years, as we know the market capitalization of GE went up about $300 billion. And during that period of time, Welch took out approximately $1 billion, and that's a lot of money, no question about it. But what did that cost per share of General Electric? Ten cents.

And when it comes to CEO pay or director pay, there is a certain reverse leverage here, pennywise, pound foolish, and I think there's a sense among shareholders that if we get an excellent CEO or if the company is doing okay, that we're not going to revolt in the streets. And then, finally, 11 months. That's the average period of time that a share of stock is held on the New York Stock Exchange by an institutional shareholder, certain large public shareholders excepted. So that you don't have a great length of time for that shareholder to get all pumped up and moved. So I think those two factors are going to probably continue the relative lassitude that we find in this dynamic between shareholders and management pay.

Matthew Bishop: My favorite Jack Welch comment, actually -- I was at a boot camp for chief executives where he was speaking. And when someone asked who should be chairman of their compensation committee, and he said, well, they need to be someone who really enjoys seeing other people get rich. And ideally they should be older than you, they should have made a lot of money, and they really just want to see you get rich. And one of the other CEOs said, I made a distinguished academic my compensation committee chair. Everyone just sort of held their heads in their hands and just shook their heads. I think if you want to solve this compensation problem, maybe the answer is to elect low-paid academics.

Joe Grundfest: By SEC mandate.

Matthew Bishop: By SEC mandate. I think that's the answer.

Joe Grundfest: Okay, well there you go. We have another sideline of business for all of us in the academic --

Female Voice: Joe Grundfest is chairman of the compensation committee at Oracle.

Matthew Bishop: Well exactly, yeah. Yeah.

Joe Grundfest: Well you know what's interesting is the conversation also suggests another potential effect in the marketplace. The data suggests that the average tenure of CEOs has come down over the last several years, from about seven years to five years. We also have this new phenomenon that's occurring of terminations for performance, rather than terminations for cause. Is it possible that we're in an environment that economists call the "sticky wage" environment, where if you're going to be bringing a CEO to operate a particular company, you know that it's likely to cost you two truckloads of money, then the game is to try to find the best possible CEO to operate the company at that price.

If you later think you're not getting pay for performance, that the equilibrating mechanism is not well, gee, we're going to reduce your pay by half. Rather, it's sayonara, goodbye. And is that, in a sense, what we saw happen at Hewlett-Packard? There the board brought in a new CEO, Carly Fiorina. She was in the job for awhile, she had a very nice pay package, but it was the opinion of the board that she wasn't working on a strategic basis, so the board brought in a new CEO, also

at a nice pay package, but this new CEO is working quite well, it appears, thank you, if you look at the stock price. And this appears to be the CEO that they're going to keep. So is it possible that the pressures we're going to see will find themselves manifest in more rapid CEO turnover, rather than in a reduction of the compensation that's paid?

Simon Lorne: If it does result in more rapid CEO turnover, the incoming CEO is going to be looking at a shorter time frame and needs a little bit more money to compensate for that risk.

Joe Grundfest: I think the ratchet can work in many different ways. I think that's right.

Joseph Bachelder: Well, when you think about it, five years of service is almost like being a project manager. It's one more year than being elected President of the United States and then getting reelected. It's not really a very long time. I think partly our problem here is that management of US corporations is very much in a very short time frame and that compensation, in the United States, reflects that very much, not only from the standpoint of management, but from the standpoint of board of directors. The compensation committee that rewarded Carly Fiorina's severance package, I believe two or three members of the compensation committee were new that fall, when she was two months away from being terminated. There's a lot to the short time frame that's involved in the US management process that is a real-time problem for matters, including compensation.

Matthew Bishop: One thing that worked very well in Britain, so far, has been the -- I know people have been boosting the British corporate governance system quite a lot -- has been the advisory vote for shareholders on executive pay. There hasn't, I don't think, been a well-documented example of it being voted down, beyond GlaxoSmithKline where it only needed one round of media-reported hostility from shareholders on the pay package for Jean Pierre Garnier to have a big impact generally, I think on the pay setting process across big British companies. And my understanding as to how it's worked is, A, it was the chairman, because we have this separation of chairman and chief executive who actually carried the most reputational damage, rather than Garnier himself, which may be a similar phenomenon that will happen here with the compensation committee chairs. And the institutions in Britain felt very much emboldened by the fact that Glaxo had to come back with a new compensation arrangement. They felt empowered to use that sort of nuclear threat to other companies that didn't come up with pay arrangements they felt were appropriate. I wonder whether there's scope for bringing in an advisory vote here -- I think that would actually be quite a helpful development.

Joe Grundfest: Questions from the audience?

Brian Foley: Joe, I want to thank you and Rob Daines for putting together this excellent program. A lot of discussion has been had about the unintended consequences and what happened in '92, when we had the enhanced disclosures of pay. Will that happen this time? I think, in

addition to the two factors that might lead boards to leave levels where they are, are the boards themselves. I think it's incumbent on the boards and their advisors -- I think we're all much smarter now in terms of governance practices to say, hey, things are out of whack. And in addition, Sy, I like your thoughts on the CD&A. Perhaps they will counter envy, in that the management and the board together, when drafting the proxy, will have to disclose the rationale and perhaps, other than CEO A got this much, and that's why we're giving that amount to CEO B, hopefully that kind of discussion can --

Simon Lorne: I'm sure you're right, watching and listening and taking heed from John White's discussion at lunch, I don't think you're going to see a lot of disclosure that says we paid them a lot because the other guy got a lot. You're going to see a more carefully articulated process. I'm not sure I view the CD&A as really very different from the former compensation committee report for the first couple of years. I suspect when they're written, if you go back and look at what compensation committees wrote in 1992, it may end up not very different because I don't think the factors that come into it are very different. The former Director of the Division is shaking his head no. I don't know about that. I didn't say it wasn't awful from the beginning. I said I didn't think this would be very different.

Matthew Bishop: To me the interesting test will be whether the compensation committee chair will take questions from journalists as to the meaning of what's in their statements.

Joe Grundfest: I think that's actually quite a good test. Joe, what do you think about the CD&A and what effect it will have?

Joseph Bachelder: First, I think if it's not over the signature of the compensation committee -- and I doubt that it would be if it is filed, because I don't think that the SEC is probably ready to try to force on compensation committee members a document that would be treated as filed -- if it's prepared by management, I think that the compensation committee is off the hook. Its input will be very different from when it's currently signing it. I really believe in looking through the CD&A materials, in the proposal. Perhaps it's the paranoid nature of a practicing attorney, but I could see -- can we hedge this, hedge that? This is a process called compensation, but it's really a result. There's a difference between reporting that and reporting the management and financial aspects of a corporation. And I think the highly subjective nature of compensation is such that it's going to be very difficult to get a really squared-corner CD&A. Maybe for a year or two, but let's regather in three or four years and see whether or not some people are murmuring boilerplate.

Joe Grundfest: You know, it's interesting, Joe, I agree with you, because I know many people that look at this proposal and see that great hope as being in the CD&A and think that it's CD&A that will really change things. The more I look at it, the more convinced I become that the situation is exactly the opposite, because, look, here we are in Washington, DC, and if there's some place that you should know that you should pay very little attention to what people say and focus on what people do, it

should be in Washington, DC? And if you haven't learned that lesson in this town, you haven't been paying attention. It will be easy, I think, for managements or directors, whoever it is that finally has to prepare the document or sign the document or what have you, to find an appropriate set of words that will be able to explain and/or rationalize whatever it is they wind up ultimately doing. People need to be held accountable for their actions, I think, more than for the textural explanation of how they actually got to that action. Because a good explanation for a bad result is still a bad result, right? A bad explanation for a good result, hey, you've still got the good result. So I would look at what people are doing rather than what they're saying about it, and again, I'm not optimistic, for all those reasons.

Simon Lorne: I'll put forward an argument for a little bit more optimism. If, and to the extent, we distinguish between compensation and incentive, I think if we can get compensation committees to articulate the kinds of incentives they're trying to create, which will inevitably lead to some public discussion, not necessarily company by company but on a broader basis, as to the effects of different kinds of incentives. There may be some value in it.

Joe Grundfest: Again, I'm thinking -- I won't name any names -- of situations where I think the comp committee is weak, I think the CEO is overpaid, and I can imagine the disclosure being: We think this is a great CEO, and it's important to pay the CEO at the level that we appreciate. We looked at other competing CEO packages, and we're very comfortable paying

this person at the top of the pile. And there you go, and people actually believe what it is that they're saying.

Joseph Bachelder: Even if you say it with action words.

Joe Grundfest: Right. You have to say it in plain English, but that certainly can be done. One last question for you in particular, Matthew, you observed, and I really do agree with you, that if we think that there's a problem in the area of executive compensation -- so let's give that assumption -- that the problem is really with the mechanisms of corporate governance and with failures in the governance area. And if that's right, treating the symptom won't really cure the problem. How would you go about trying to change the governance mechanism so as to be able beneficially to affect this symptom, if it is one, and several other symptoms in the area?

Matthew Bishop: I don't know if there's any simple answer to it, but I suppose my observation is that the institutional shareholders are not held to account very well for how they do their corporate governance, by and large. We don't do a very good job of it in the press because I guess for all those Michael Jenson reasons it's very hard to. I think the phrase "pension fund trustee," that phrase alone, relegates you from being an interesting publication, if you use it. It's quite a difficult area, and maybe once the baby boomers start to retire and find they haven't got a pension they thought they were going to have, maybe it becomes quite a hot topic at that point. But that's 20 years down the line. I really agonize over how we can do a better job of shaming intuitional

shareholders into doing the corporate governance job more effectively. And maybe that's something that we in the press need to look at more, and maybe there's more transparence --

Joe Grundfest: It's interesting that what you need to do is shame the intuitional investors, rather than the executives, because they are arguably at the root of the problem. And we now have Nell Minow.

Nell Minow: I just have to say that we released last week the very first report ever about the way that money managers vote their proxies on executive compensation. And you're right, the results are absolutely shameful. Anyone who wants a copy of the report, just give me your business card, or you can look at our website. You have companies like Morgan Stanley voting 94 percent in favor of executive compensation, including executive compensation plans which our firm gives an F to. So maybe they don't deserve an F. Maybe they deserve a D. Or maybe they've got their own idea about what deserves an F, but the fact is there's no question, and the report is called "The Enablers of Executive Compensation," because, yeah, there's an addiction, and everybody needs a big Betty Ford intervention for this. So, yeah, I do agree, and I do call on you, Matthew, to all the press that are here, to bear down more on the enablers of the executive pay, and not just the compensation committees and the executives.

Joe Grundfest: That's interesting, and maybe that's an appropriate note on which to end this session. The problem doesn't lie in the stars. It's not in the CEOs or the directors. We ourselves are the problem to the extent that

we're all the investors that allow this process to go on and not using the authority that we have to try to change it. So, with that note, ladies and gentlemen, thank you very much for joining us today. You've been a terrific audience. This has been a great panel. And thanks for helping make this inaugural session as much of a success as it's been.

[Applause.]