Eli Lilly and Company
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Indianapolis, IN 46285

April 10, 2006

Nancy M. Morris, Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

VIA E-MAIL (rule-comments@sec.gov)

Re: **Executive Compensation and Related Party Disclosure**
File No.: S7-03-06
Release Nos.: 33-8655; 34-53185; IC-27218

Dear Ms. Morris:

Eli Lilly and Company, a global, NYSE-listed pharmaceutical company based in Indianapolis, Indiana, submits this letter in response to the Commission's request for comment in connection with the Executive Compensation and Related Party Disclosure proposals.

Overall, we support both the direction of the proposals and most of the specific provisions. However, we have some suggested changes that we believe will improve the overall quality and usefulness of the disclosures while reducing the burden on issuers. In this regard, we are mindful of the admonition that proxy statements are already lengthy and difficult to read, and therefore more is not always better. We have tried to identify those disclosures that we believe, based on (i) knowledge of our compensation programs, (ii) our own experience in reviewing other companies' disclosures, and (iii) feedback from our investors, are likely to be confusing, duplicative, or simply not meaningful.

In this regard, we have participated in drafting the comments provided by the Society of Corporate Secretaries and Governance Professionals (the "Society"), provided in its letter of April 6, 2006. Unless otherwise indicated, we support the comments and recommendations submitted by the Society. We are providing additional comments below. Our comments follow the order taken in the proposed rule, and we are restating in bold those requests for comment to which we are responding.

II. Executive and Director Compensation Disclosure

A. Compensation Discussion and Analysis

We agree that a more analytical discussion of executive compensation would result in more substantive, transparent disclosures. We believe that the substantive guidance provided by this portion of the proposed rule is very helpful.

- **Is there any significant impact by not having the report over the names of the compensation committee of the board of directors?**

We agree with the comments provided by the Society on this point, and feel that the compensation report should be presented over the names of the compensation committee, consistent with good corporate governance practices.

- **Would any significant impact result from treating the Compensation Discussion and Analysis as filed and not furnished? A commenter that prefers furnishing over filing should describe any benefits that would be obtained by treating the material as furnished. In particular, such a commenter should describe those benefits in the context of the expected benefits of the Commission's decision in 1992 to treat the report of the Compensation Committee as furnished and should address whether and why those benefits were achieved or not achieved.**

Again, we agree with the comments provided by the Society on this point that the compensation report should be furnished rather than filed, to, among other reasons, avoid the conflict created if this report were subject to certification by the CEO and CFO.

In addition, while we do not have a major concern over increased liability to the Company if the report were to be filed rather than furnished, we question whether imposing that requirement will improve the quality of disclosures. As is the case with many 1933 Act prospectuses today, fear of litigation – warranted or not – may lead many registrants to adopt defensive disclosure postures that would yield dense, overly detailed disclosures that are at best not helpful and at worst obfuscate the most important points. The proposed CD&A rules are "principles-based" and would require companies to exercise judgment as to what is "material" to an understanding of the wide range of complex matters to be disclosed in the tables and narratives specified by other parts of the rules. We believe that in applying these requirements, many registrants would respond to the litigation risk by resolving the least doubt about what needs to be discussed, and in what detail, in favor of an expansive CD&A. There is a risk that the CD&A will become excessively detailed, and not useful to investors as an "overview" of what is "most important" to an understanding of the detail presented elsewhere in the disclosure.

For all these reasons, we do not believe it is desirable or necessary to treat the CD&A as "soliciting material" or "filed." If the SEC nonetheless wants to increase the liability risk associated with CD&A, we urge that the CD&A be deemed "soliciting material" and "filed" for purposes of the proxy statement only. This approach would eliminate the need for the Chief

Executive Officer and Chief Financial Officer to certify the CD&A, which is not practicable as described in the Society's comments.

4. Proposed Elimination of the Performance Graph and the Compensation Committee Report

- **Should we retain the Performance Graph?**

No. This information – and much more in the way of comparative performance data -- is now readily available on the Internet. Further, we agree with the view that total shareholder return is just one of many corporate performance measures that may be relevant to assessing whether executive compensation is appropriately linked to performance.

B. Compensation Tables

1. Compensation to Named Executive Officers in the Last Three Completed Fiscal Years – The Summary Compensation Table and Related Disclosure

a. Total Compensation Column

- **Should we include a requirement to disclose a total compensation amount?**

We agree that a total compensation amount would be of interest to investors, and we do not object to its disclosure. However, we believe a single total that includes both earned amounts and contingent amounts may be misleading because the executive may never receive the contingent amounts. Thus, we support the recommendation of the Society that there be two separate tables (each with a total column) – one for compensation earned during the year, and one for contingent compensation granted during the year but not yet certain of being received. If that approach is not acceptable, we also support the Society's alternate suggestion of a single table but with two separate total columns – one for earned compensation and one for contingent compensation.

- **Should total compensation be calculated in a different manner from that proposed? For example, with respect to stock-based and option-based awards, should exercise or vesting date valuations be used instead?**

We agree with the proposed valuation methodology for option-based awards and non-performance based stock awards. However, as discussed in the Society's comments, we believe that performance-based stock awards should be included in the Summary Compensation Table in the year earned, not the year granted. The Society's suggestion of splitting total compensation into two tables, one for earned compensation and a second for contingent compensation, with totals shown separately on each table, is a good alternative that would eliminate this concern.

The proposals would require defined benefit plan benefits to be included in the All Other Compensation column of the Summary Compensation Table in the year paid, and thus included in total compensation for purposes of determining named executive officers. Annual actuarial

increases in defined benefit plan benefits are also proposed to be included in the All Other Compensation column as they accrue. For the reasons described in the Society's comments and our response to II.B.1.d "All Other Compensation Column" below, we believe these items should be eliminated from the All Other Compensation column entirely, or, at a minimum, be excluded from total compensation for purposes of determining the named executive officers. Disclosure of these items in the Summary Compensation Table will result in significant distortions and volatility in who is a named executive and in reported total compensation, which will hinder rather than facilitate the goal of transparency of executive compensation decisions and governance.

d. All Other Compensation Column

i. Earnings on Deferred Compensation

- **Should we require, as proposed, disclosure of all earnings on compensation that is deferred on a basis that is not tax-qualified or should we require disclosure only of above-market or preferential earnings? If the latter, please explain why such an approach is more useful or informative for investors than our proposed approach.**

We agree that disclosure in the "All Other Compensation" column of the Summary Compensation Table is appropriate, with details provided in a footnote, for all compensatory items relating to deferred compensation.

We agree that all guaranteed returns and above-market earnings on account balance type deferred compensation which accrued during the most recent fiscal year should be reported in the Summary Compensation Table where the return is based on a fixed rate of interest, as those amounts are compensatory. However, we do not believe that the market-rate portion of non-guaranteed returns should be reported in the table. These amounts are best characterized not as compensation, but as a market rate of return, just as if these funds were invested outside of the company plan. We recommend that the market-rate portion of deferred compensation earnings be excluded from the table, but have no objection to reporting it supplementally in a footnote.

ii. Increase in Pension Value

- **Is the aggregate increase in accrued actuarial value the best measure for disclosing annual compensation earned under defined benefit and actuarial plans? If not, why? What other method should be used?**

We agree with the comments presented by the Society on the problems created by including aggregate increase in accrued actuarial value in the All Other Compensation column and that, at a minimum, these amounts should be excluded from total compensation for purposes of determining named executive officers. In addition to the examples presented by the Society, note that large one-time spikes will occur in the increase in actuarial values in the year in which an executive first becomes eligible for early retirement or first becomes eligible for a higher tier of benefit. For example, a hypothetical Lilly executive is the eighth highest paid executive. She

is nearing, but has not yet reached, the early retirement age, and will therefore experience an annual actuarial increase of approximately $20,000. In the year in which she first qualifies for early retirement, her actuarial increase will be approximately $3,700,000 – significantly more than her annual salary and bonus combined – vaulting her, for that year only, from the eighth highest to the second highest paid executive. In the next year, her actuarial increase drops down to approximately $700,000 and she becomes the seventh highest paid executive. This volatility would further distort the overall picture of the company's executive compensation practices and lead to investor confusion.

iii. Perquisites and Other Personal Benefits

- **Is $10,000 the proper minimum below which disclosure of the total amount of perquisites and personal benefits should not be required? Should there be no minimum? Should the minimum be a higher amount, such as $25,000 or $50,000? Should the current minimum of the lesser of $50,000 or 10% of total salary and bonus be retained? Would some other ratio be more appropriate?**

We believe that $10,000 is too low. We recommend that the threshold be established at $25,000. We believe that the costs and burdens related to compiling the data for disclosure would outweigh any additional benefit gained from the proposal.

- **Is the greater of $25,000 or 10% of the total amount of perquisites and personal benefits the proper minimum below which perquisites and personal benefits should not be required to be separately identified and their value reported? Should there be a lower minimum, such as $10,000, or no minimum? Should the current minimum of 25% of the total amount be retained?**

We support the $25,000 / 10% test.

- **Should perquisites and personal benefits below the proposed threshold be separately identified by category, even if not separately quantified? Alternatively, is separate identification and quantification of all perquisites and personal benefits so significant to investors that no threshold should apply for either purpose?**

No. Amounts below the threshold are simply immaterial, and the burdens of collecting the information outweigh any benefits of disclosure.

- **We propose to retain the current standard for valuing perquisites and other personal benefits, based on the aggregate incremental cost to the company and its subsidiaries which has applied since 1983. We believe that this approach is consistent with the approach we are taking otherwise in valuing compensation, including in respect of share-based compensation. Nevertheless, we realize that there may be an issue whether the retail value of what is received by the executive officer, or director, rather than the aggregate incremental cost to the company, better measures the compensation provided by perquisites and other personal benefits. Therefore, we request comment as to whether we should require**

perquisites and other personal benefits to be valued based on the retail price of the item, or, if none, the retail price of a commercially available equivalent. In determining the commercially available equivalents, for example, for travel on the company's aircraft, the retail price of a commercially available equivalent would be the retail price to charter the same model aircraft. First-class airfare would not be considered equivalent to travel on a private aircraft.

- **Would the proposed valuation standard facilitate Item 402 compliance while providing meaningful compensation disclosure? Is there any other valuation methodology that is preferable for valuing perquisites and other personal benefits? If so, why?**

We agree that the use of incremental cost to value perquisites and personal benefits is the appropriate measure, and, thanks to recent clarifications from the SEC staff, we believe it is a measure that is now well understood by issuers. We believe that the use of the retail price of a commercially available equivalent to value perquisites would be inconsistent with the approach taken by the Commission with respect to other aspects of compensation disclosure (e.g., the use of FAS 123(R) compensation cost to the company to value stock option awards) and would lead to a whole new set of interpretation questions.

2. Supplemental Annual Compensation Tables

a. Grants of Performance-Based Awards Table

- **Will the proposed Grants of Performance-Based Awards Table effectively supplement the equity awards and non-stock incentive plan compensation information to be disclosed in the Summary Compensation Table? In particular, should tabular disclosure be required of any additional information relating to performance-based equity awards and non-stock incentive plan awards?**
- **Is the information required by columns (b), (c) and (d) of this proposed table redundant with the information required in the Grants of Performance-Based Awards Table describing estimated future payouts to be required in columns (h), (i) and (j) of the Table, such that any of these columns should be eliminated? Is any other tabular information needed to describe estimated future payouts in addition to the information that would be required in proposed columns (h), (i) and (j)?**

We concur with the Society's comments on this table. Some of this information is duplicative of Section 16 reports (which are now easily accessible on the Web) and therefore the table can be considerably simplified to make it more useful and less burdensome to generate.

Also, we recommend that the Commission carefully consider this chart in relation to the disclosure of incentive-based awards in the Summary Compensation Table, to ensure there is neither an omission nor a duplication of disclosure.

b. Grants of All Other Equity Awards Table

Like the proposed disclosure in the other supplemental table, nearly all of the information sought to be disclosed here would already be disclosed in Section 16 reports and therefore available to investors on a more immediate basis. Accordingly, we believe that this supplemental table should simply report the number of underlying securities and the value as stated in the Summary Compensation Table.

We object to the requirement in proposed Instruction 5 to Item 402(e) that the market price of options, SARs and similar option-like instruments be the closing price per share on the relevant date. This creates the potential for required disclosure of a "discounted" value for these instruments where a company uses another, currently acceptable, valuation method. For example, if the company uses the average of the high and the low on the grant date, and this average is lower than the closing price, the company would be required to add a second column to the table showing the higher value using the closing price. The price difference is unlikely to be meaningful, and the dual columns are a confusing format to present to investors. In addition, there is an argument that this disclosure could create tax issues for the company under Section 409A, which treats discount stock rights as involving a deferral of compensation.

3. Narrative Disclosure to Summary Compensation Table and Supplemental Tables

- **Would the proposed disclosure of up to three employees who are not executive officers but earn more in total compensation than any of the named executive officers be appropriate in the narrative discussion? Should more disclosure be required regarding these employees and their compensation? Is this information material to investors? Will disclosure of this information, particularly in the case of smaller companies, cause competitive harm? Is disclosure of this information consistent with the overall goals of this proposal?**

We agree with the comments provided by the Society and strongly urge the Commission not to adopt any requirement to disclose compensation of any person who is not an executive officer of the registrant because the competitive harm this type of disclosure will cause to companies heavily reliant on human capital – such as Lilly and other companies in our industry – will far outweigh any perceived benefit from providing this information. The size of the company does not make a difference in this regard – a key employee is a key employee. Although the names and titles would not be disclosed, the proposal calls for such specificity in the job description that, in many cases, knowledgeable competitors and headhunters would be able to readily discern the identity of the individual and use the information to formulate competitive offers.

Further, we do not see how disclosure of individual pay decisions for employees who are not executive officers has any bearing on the matters the proxy statement is intended to address, that is, the election of directors. Non-executive pay decisions are matters left to the discretion of management, not compensation committees, and are typically market-driven. Disclosure of this private data may be interesting to some people but it serves no legitimate shareholder interests. We believe this proposed additional disclosure is, at best, a distraction from the important issues

surrounding executive compensation and board governance. At worst, it is an invasion of privacy to the individuals involved and a competitive threat to issuers.

5. Post-Employment Compensation

a. Retirement Plan Potential Annual Payments and Benefits

- **Should any other information (including information that may be disclosed in the narrative) be included in the proposed table? Should any of the information we propose to require to be disclosed be excluded?**

We support this table as proposed.

- **Should this item require quantification of the aggregate actuarial value of a plan benefit as of the end of the company's last fiscal year without regard to whether the plan permits a lump sum distribution? If so, why? Alternatively, would this information provide meaningful disclosure only if the named executive officer currently is eligible to retire under the plan with a lump sum distribution?**

For the reasons discussed above (regarding inclusion of actuarial increases in the Summary Compensation Table), disclosing actuarial values is potentially misleading and confusing where the benefit is payable only as an annuity. However, where the plan permits lump sum payments, the aggregate actuarial value would be a meaningful disclosure.

b. Nonqualified Defined Contribution and Other Deferred Compensation Plans Table

- **Should only above market or preferential earnings be included in the table? If so, why would such disclosure be more useful or informative to investors?**

As discussed above under II.B.1.d.i "Earnings on Deferred Compensation", we recommend that only above-market, preferential or guaranteed earnings be included in the All Other Compensation column of the summary Compensation Table. For the same reasons, we recommend the same result in this table. We have no objection to disclosing the entire amount earned during the year, but it should be in a footnote, rather than in a table.

6. Officers Covered

a. Named Executive Officers

- **Should the principal financial officer be specifically included as a named executive officer?**

Yes.

- **Would the proposed named executive officers be those executive officers whose compensation is material to investors? Is only the compensation of the principal executive officer material? The principal executive officer and the principal financial officer?**

Including the CEO, CFO and the three other most highly compensated executive officers is reasonable in scope and strikes an appropriate balance between keeping investors informed and unduly burdening the company with excessive disclosure.

b. Identification of Most Highly Compensated Officers; Dollar Threshold for Disclosure

- **Are there any particular circumstances or categories of companies for which a measure other than total compensation should be applied to identify the most highly compensated executive officers? If so, what measure should be applied and why? Is $100,000 the correct disclosure threshold?**

The current rule, which is set forth in Instruction 1 to Item 402(a)(3), should be retained. The determination as to which executive officers are most highly compensated should be made by reference to total annual salary and bonus for the last completed fiscal year and not on the basis of total compensation. The current rule is clear and precise and can be applied quickly by companies. It fosters stability in the identification of the named executive officers from year to year, which benefits both investors (because they can more easily understand compensation trends over time) and issuers (because they can more easily identify which executives' compensation must be tracked for possible disclosure).

Our primary concern is with applying the All Other Compensation column to the determination of the most highly compensated executives. Especially if the column includes defined benefit pension amounts and deferred compensation earnings, this number could be very volatile from year to year, resulting in executives jumping in and out of the proxy statement in successive years based not on compensation committee decisions about their pay but instead on the executives' ages and movements in interest rates and equity investment returns. This lack of stability presents significant administrative challenges for issuers and would not aid investors' understanding of the issuer's compensation practices.

- **Should payments attributable to overseas assignments be included in determining the most highly compensated officers, given that the purpose of such payments typically is to compensate for disadvantageous currency exchange rates or high costs of living?**

Payments attributable to overseas assignments should not be included in determining the most highly compensated officers. As noted in your question, these payments are typically made to "equalize" the overseas employee who is residing in a high-cost-of-living (or heavily taxed) country. Including these payments in the determination could result in "elevating" to the proxy statement an employee who would not be considered by the compensation committee to be one

of the most highly compensated, and "hiding" another employee whose compensation should be disclosed.

9. Compensation of Directors

- **With respect to disclosure of perquisites, should the director compensation apply the same $10,000 disclosure threshold as proposed for the Summary Compensation Table? Should separate identification and quantification apply to director perquisites?**

We believe that the same rules (including our recommended $25,000 threshold) should apply.

We appreciate the opportunity to comment, and commend the Commission on the direction and content of these proposals.

Sincerely,

\s\ James B. Lootens
Corporate Secretary