April 28, 2006

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

RE: Executive Compensation Disclosure Proposal
File No. S7-03-06

Dear Ms. Morris:

As undertaken in the undersigned's letter of March 1, we are providing the following additional important comments relating to the Commission's executive compensation disclosure proposals.

The comments below also reflect the undersigned's having read - and reflected upon - every comment letter that has been posted on the SEC's website over the course of the last three months. (The Staff and the Commission are to be lauded that the proposals have elicited so many constructive comments - and, although the rules cannot please all constituencies, the proposals generally have been on or near the mark.)

The following suggestions address fixes to the proposals that are critical to ensuring the integrity of the final rules. Having the benefit of receiving candid, off-the-record comments and suggestions from practitioners with varying perspectives and having been immersed over the last few years in trying to restore integrity and public trust in the system, the undersigned is offering the following for the sole purpose of increasing the likelihood of forthright compliance with the intent, as well as the literal requirements, of the final rules. The following are truly in the long term interests of all.

1. The CD&A

a. The Stanford Rock Center Conference Concerns

As Simon Lorne, Joe Grundfest and others expressed at the Stanford Rock Center Conference held in Washington on April 3rd, with more numbers set forth in proxy statements, there is a real risk that "envy" will cause existing excesses to worsen. A critical aspect of the proposed disclosure requirements that can provide shareholders with essential information to address these very real concerns centers around the new CD&A.

As we know, the SEC does not have the authority to correct excesses in pay practices. But it is the SEC's responsibility to ensure that investors have the necessary information in order to take appropriate action where it appears that directors may not be fulfilling their obligations to shareholders. That is why it is so critical that the Commission carefully craft the final requirements relating to the CD&A.

b. Whose Report?

Having paid particular attention to the various comments relating to the proposed CD&A, it appears that most commentators would like to see the report come from - and be signed by - the compensation committee. Many respected commentators also supported the need for, and importance of, the proposed CD&A "filed" approach.

After reflecting on all the comments addressing the "filed" vs. "furnished" issue, we are convinced that a middle ground approach can accomplish everyone's objectives here. As has been suggested by a number of commentators, the SEC should stick by its convictions and adopt the proposed CD&A "filed" approach to provide greater integrity to the disclosures and explanations. It is clear that the "furnished" approach - even with exhortations from the Staff and others to practitioners over the last few years - has not achieved the level of disclosure and analysis that is called for under the current compensation committee report requirements.

To make it clear that the directors on the compensation committee "own" the report and feel accountable for it, the compensation section should be followed by their names beneath a "furnished" statement, similar to the audit committee report. (*See, e.g.*, the comments of Kellogg Company (March 16 at pg 1), the 16 major institutional investors representing $1.5 trillion of investor assets (Dennis A. Johnson, *et al*, April 10 at pg 5), State Board of Administration of Florida (April 10 at pg 4), and most of the compensation consulting firms that have submitted comments.) To further underscore the review and "ownership" of the report by each of the compensation committee members, we very much like the suggestions of Kellogg and others that each director on the committee sign a copy of the CD&A to be retained by the company.

As recommended by several respected commentators, particularly the comments representing the interests of shareholders, the directors' names should be beneath a statement that the compensation committee approved the CEO's compensation and the disclosures in the CD&A. We note that a number of companies have already added such a representation to their compensation committee reports along the following lines: "The Compensation Committee finds that the total compensation (and, in the case of severance and change-in-control scenarios, the potential payouts) paid and payable with respect to the CEO and the other named executive officers to be reasonable and not excessive." (See the several proxy statements cited in Mark Borges' Compensation Disclosure Blog on CompensationStandards.com, including Libbey Inc., Allied Waste Industries, Inc., Kellogg Company, and Fifth Third Bancorp.)

c. Principles-Based and Rules-Based

What is important here is to come up with an approach that will work to accomplish the goals that nearly everyone is espousing. For example, the Business Roundtable's April 10th comment letter endorses "providing shareholders with meaningful and understandable information about a company's executive compensation practices" citing two BRT reports in which the BRT states "The compensation committee should oversee the corporation's disclosures with respect to executive compensation. In particular, the committee should use the compensation committee report included in the corporation's annual proxy statement to provide shareholders with meaningful and understandable information about the corporation's executive compensation practices." (*Principles of Corporate Governance* (2005) at pg 24.) "[T]he factors that the compensation committee and the board consider in making compensation decisions, and the relationship between executive compensation and corporate performance [should be disclosed]. [C]ompensation committees should furnish understandable information about the performance metrics the corporation employs." (*Executive Compensation: Principles and Commentary* (2003) at pg 10.)

As pointed out in candid comment letters from those who have been an integral part of the compensation setting and disclosing process - and thus speak from actual experience - there is a real risk that compensation committee reports will continue to be crafted by persons other than the compensation committee members (lawyers and professionals) and that boilerplate or obfuscating language will continue to be the norm (only with a new list of "checklist items" to give lip service to touching all the bases with high sounding language that still will not provide shareholders with the forthright *analysis and accountability* that shareholders - and the SEC - are seeking in the CD&A.

The problem that these commentators have put their collective finger upon is that principles-based disclosure will not work unless it is accompanied with additional rules-based requirements. Leading institutional investors have asked for the CD&A to supplement the principles-based approach with mandated rules. For example, "we strongly support the proposed approach integrating the strengths of a principles-based approach *with some rules-based criteria to ensure specific topics and concepts are discussed in the CD&A"* (Council of Institutional Investors, March 29, Appendix I at pg 1, emphasis added); see also the comments of ICGN (April 10 at pg 1); State Board of Administration of Florida (April 10 at pg 4) and the strong message to the SEC in the comments from Steven Hall & Partners (April 10, pgs 8-9).

d. The Staff's Experience

The Staff knows from its own experience that even squarely confronting practitioners who have taken a very literal position about complying with the compensation disclosure rules hasn't changed things; that unless requirements are spelled out in very specific mandated terms, some lawyers and other drafters, understandably will continue to feel a greater obligation to management (that pays the practitioner's bills) than to the ultimate client - the shareholders.

e. Telling Comments From Those Inside

It cannot be dismissed when a highly respected former CEO who has also sat on several boards (who knows as well as anyone how things work with respect to CEO compensation and the disclosures in the compensation committee report) takes the time to speak up and say "I believe absolutely that without very specific mandated disclosures, many lawyers will continue to advise their clients to draft disclosures that will continue to disguise or at least mislead shareholders about the compensation…that executives are receiving." (Warren L. Batts, Retired Chairman and CEO of Premark International and Tupperware Corp., April 14).

It also is very telling when a seasoned compensation consultant feels compelled to submit a comment stating "there is one area where my professional colleagues appear reluctant to comment - the need to require that the compensation committee report contain specific mandated disclosures.…[I]n my experience, unless there are also mandated disclosures, the reports will become another 'hide-go-seek' game." It is also indicative of the pressures even responsible consultants must feel when this consultant with "thirty years experience" says he/she must sign the comment letter anonymously because "my firm prefers to keep a very low profile on such matters" and refers to colleagues' "fear of alienating clients." (A Concerned Compensation Professional, April 17).

Similarly, the following submitted by the head of the compensation consulting practice of a major consulting firm cannot be taken lightly:

> [R]egarding the proposed CD&A, some of my clients seem pretty concerned…so the new rules really have their attention. In response, however, some are fuzzing up this year's compensation committee report to be less precise (To give an example, I told one client that it seemed they were going backwards in openness in this year's compensation committee report, but the attorneys encouraged them to go with a broad statement, rather than state the actual facts). So, I worry that next year's CD&A will be even fuzzier unless the SEC mandates some very specific points to be covered. That is why I strongly support the need for specific required disclosures in the CD&A.
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> Those disclosures should address, in particular, the committee's actions with respect to how the Committee evaluates pay for performance and internal pay equity. It has been my experience and that of other consultants that when boards are presented with tally sheet numbers that reveal large surprises, after an initial "holy cow" reaction, often nothing is done to change or redress unintended amounts. If compensation committees were required to disclose to shareholders whether they focused on pay for performance and internal pay equity and what actions they took if they found elements of their CEOs compensation that had gotten out of line, shareholders would finally have the kind of disclosure that would be meaningful in getting to whether a compensation committee is fulfilling its obligations to shareholders.
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> An equally important disclosure that compensation committees should be required to address in the CD&A is whether, and how, the committee factored in already accumulated equity gains, when (a) taking actions on future equity grants and (b) reviewing retirement and severance and change in control arrangements and setting limits and offsets to take into account accumulated gains. These are areas where CEO compensation has gotten out of line and where boards have generally

not acted to reverse past mistakes and unexpected outcomes. Shareholders should be provided this information in order to asses the compensation committee's actions with respect to the most troublesome areas of executive compensation. Without these specific required disclosures, I fear that the disclosures in the CD&A will not be very helpful because skilled lawyers will be able to continue to fudge with generalities that are, in fact, not very useful to shareholders. (Anonymous, April 4.)

f. Tally Sheets, Accumulated Wealth and Internal Pay Equity Disclosures

Several of the comments noted above and others singled out the need to address the board's consideration of accumulated wealth and internal pay equity, in particular. These are basic – and go to the heart of the integrity of a board's "analysis" of the CEO's compensation. In fact, it was brought to our attention that the NACD's 2004 Blue Ribbon Report on the Role of the Compensation Committee, which sets forth five "core principles that should apply almost universally when examining compensation matters," lists "fairness" (*i.e.*, internal pay equity - see pg 21 of the NACD report) as the #2 core principle. Whether the SEC labels it "fairness" or "internal pay equity," there will need to be a specific instruction that this core principle be addressed in the CD&A. Rather than belabor the point, we respectfully urge the Commission to refer to the above comment letters and the undersigned's comment letter of March 1.

2. Fixes to the Tables

a. Realized Gains

A number of letters that focus on the importance of the tables that would illustrate the wealth accumulated by the CEO and NEOs make the important point that the information in the Beneficial Ownership Table and the Outstanding Awards at Fiscal Year-End Table - even when combined - still omit a critical piece of information: the dollar value of gains realized during the executive's tenure. (*See, e.g.*, Vivient Consulting, April 3 at pg 1).

As Cary Klafter of Intel Corporation (April 6 at pg 8) and others point out, there is a perverse risk that to avoid showing huge accumulated gains, some executives may be encouraged to reduce their holdings. Requiring that realized gains during the executive's tenure also be included will nip this in the bud, while at the same time providing essential information necessary for shareholders to see and assess the total wealth accumulation picture that the compensation committee will be looking at and that will be discussed and *analyzed* in the CD&A.

b. Airplane Perks: Incremental Cost—Two Problems Persist

Perhaps the perk with the largest value (and a "hot button" for investors and the general public) is airplane usage. So it is important that the disclosure requirement here does not perpetuate the continuing disclosure problems with airplane use.

Problem 1: No Clear Definition or Understanding of What "Costs" to Include in the Disclosure

The following recent exchange of posts from the "Evolving Compensation Practices Q&A Forum" on CompensationStandards.com demonstrates that the actual costs and amounts being disclosed as "incremental costs" vary widely. There is no way that shareholders - or even sophisticated counsel who draft the airplane perk disclosures and are, in good faith, attempting to find out what others are doing - can glean from proxy statements the costs a particular company may (or may not) be including. Thus, the end result today is opaque, inconsistent and misleading disclosures of what are already large numbers.

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We are in the process of re-evaluating the disclosure to be made in respect of the personal use of the corporate aircraft by the executive officers and considering the costs to be included in the calculation of incremental cost to the company. I am aware that among the variable costs often taken into account are hangar and tie-down costs away from the aircraft's home base; landing fees, airport taxes and similar assessment; flight planning and weather contract services; crew travel expenses; in-flight food and beverage; insurance obtained for the specific flight; aircraft fuel per hour of flight; aircraft accrual expenses per hour of flight; aircraft accrual expenses per hour of flight; maintenance, parts and external labor (inspections and repairs) per hour of flight; customs, foreign permit and similar fees directly related to the flight; and passenger ground transportation. Where the aircraft is primarily used for business purposes, fixed costs which do not change based on usage are often excluded from the disclosed cost.

In calculating the incremental cost, it would seem that the costs associated not only with the flight on which the executive travels but also any deadhead flight (*i.e.*, an empty flight to pick up the executive or to return to the aircraft's home base) would be characterized as variable costs as well. I would appreciate input as to the practices which other companies might have in this regard.

Additionally, would the loss of a tax deduction to the company under the strictures of Code Section 274(e) also fall within the calculation of aggregated incremental cost? I have not seen this issue addressed yet, but may have missed it.

Anonymous

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Everything that you say regarding methodology appears to be true, but different companies are applying different methodologies. Deadhead flights present difficult issues, and the tax deduction is even more difficult.

I’ve talked with companies going both ways on the tax issue. I think the best thing for companies to do is adopt a methodology and disclose it. Over time, either the market or the SEC Staff will bring uniformity to the presentations.

Broc Romanek
Editor, CompensationStandards.com

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I whole-heartedly share your concerns regarding this issue. If you are able to find a source of detailed benchmarking information please let us all know.

We have been trying to stay in step on how to measure incremental cost, but the lack of information makes it difficult. Although I can’t fault the logic or simplicity of Broc’s advice to disclose the methodology adopted, I don’t think this will be happening too much, as many companies are reluctant to disclose specifics for fear of being criticized for not picking up what others may think of as costs.

As to our methodology, we include variable costs only (fuel, fees, catering & a variable maintenance charge calculated on an hourly basis). This year we also included the lost tax benefit under Sec. 274 as an incremental cost, but in order to make sense out of this, we also “tax effected” the variable costs since these are otherwise deductible. We have not to date included the cost of deadhead flights in the incremental cost tally.

Anonymous

The IRS Has Now Provided Guidance on Calculating the Costs

It should be noted that in Notice 2005-45, the IRS has now provided detailed guidance on what expenses must be taken into account under IRC Section 274(e)(2)(B) and the method of allocating expenses for flights. We suggest that the Commission adopt the method outlined in Notice 2005-45, which could provide consistency in the proxy disclosures. [The Commission needs to be aware of the need to make clear in the final rules that companies need to add the costs associated with a company’s lost deductions under Sections 274(e) and 162(m) - so that companies know that these lost deductions will have to be attributed to the CEO’s and NEOs’ compensation or at least be treated as incremental costs.]

Note that the foregoing assumes retention of the “incremental cost” approach. As can be seen below, it should be replaced by disclosure that shows the value (*i.e.*, “compensation”) to the executive—not the cost to the company.

Problem 2: Compensation to the Executive—Not Cost to the Company

We direct the Commission's attention to a number of letters that suggest that the appropriate airplane perk value that should be disclosed to shareholders is the value of the benefit to the executive (*i.e.*, the retail cost to the executive of chartering a comparable private aircraft). (*See, e.g.*, Frederic W. Cook & Co. March 9, at pg 7 and Pearl Meyer & Partners, April 10, at pg 8.) As articulated by one of the largest public pension funds, "[i]t would be inconsistent to report other components of executive compensation at fair value (such as stock options) and not do the same with perquisites." (State Board of Administration of Florida at pg 7.) As stated in a comment letter from someone in the know, "[i]n the case of corporate aircraft use, an issue arises as to whether the company has purchased or contracted for aircraft capacity in excess of its business needs in order to make aircraft available as a perquisite. We suggest that a disclosure be required as to the percentage of total hours flown by company aircraft represented by the executive's personal use which constitutes a perquisite." (Steven Hall & Partners, April 10 at pg 5; *see also* CFA Institute, April 13 at pg 8.)

If the Commission is reluctant to drop the incremental cost approach, we would urge a compromise position: Also require a brief footnote that shows the retail value of the flights, including actual hours flown by the executive for personal use and the percentage it represents of the total hours flown by that aircraft for company business use.

c. Pledging and Hedging

The Commission should not overlook that there must be clear disclosure of hedged positions of executives. It is misleading to report an executive's holdings in company stock if the executive has already hedged his upside potential (and downside exposure). Indeed, many responsible advisors have counseled against executives engaging in hedging transactions. And many companies have in place - and should disclose to shareholders - policies prohibiting executives from engaging in hedging transactions in company stock. This information is just as important as disclosing pledges. I offer this as a personal comment as someone who has been involved with transactions by affiliates for 35 years.

3. All Compensation Covered

We note that the proposals have retained, with minor revisions, Item 402(a)(2) of Regulation S-K regarding the requirement to provide "clear, concise and understandable disclosure" of all compensation from all sources. Despite the fact that this rule would appear to be unambiguous on its face, there has been some confusion among practitioners of whether "all" means "all." In fact, then-Director Alan Beller felt the need to address this precise issue in a speech in October 2004. In light of the confusion, we urge the Commission to specifically discuss Item 402(a)(2) in its adopting release so that there can be no misinterpretation of the rule.

4. Transition - Adoption

Although there are many companies that are already anticipating and preparing for the new disclosures, inevitably there will be many companies that will need as much time as possible to gear up for the new rules. We would urge the Staff and the Commission to adopt final rules as soon as possible, ideally by mid-September. This would also give many companies enough time to provide three years of comparative data in the tables on at least a voluntary basis.

We note that in 1992, when the last major overhaul of the compensation disclosures was undertaken, final rules were adopted 46 days after the close of the comment period. We know that this time around, it will take longer. However, notwithstanding all the comments that have been submitted, the proposals in their current state are in good shape. Hopefully, the proposed fixes that we and others have advocated will not take long to work into the current proposed rules.

5. The Need – and Benefits - of Announcing a Follow-Up

It would be naïve to assume that the final rules will be perfect. Rather than delay adoption past mid-September, we would encourage the Commission to announce in the adopting release that it will keep this rule-making project open during the year and that the Staff will continue to monitor the coming year's proxy disclosures, in particular, with the expectation that there may well need to be a follow-up proposal by the summer of 2007 which would be adopted in time for the ensuing proxy season. [Just providing follow-up interpretive guidance will not be enough. Unfortunately, for many to change their ways in such a sensitive area, it takes rules, not guidance.]

Practitioners drafting the disclosures - and the general public - need to know that the Commission is committed to getting it right. Another real benefit would be that the prospect of knowing that the Commission might come back with stronger proposals next year might cause some companies to be more forthcoming in complying with the letter and the spirit of the final rules the first time around.

If you have any questions with respect to the above or require additional amplification or clarification, please feel free to contact the undersigned at 925.685.5111 or, during the month of May while I am out of the country, Broc Romanek, who is Editor of CompensationStandards.com, at 703.237.9222.

Respectfully Submitted,

<u>/s/ Jesse Brill</u>
Jesse M. Brill
Chair, CompensationStandards.com
Chair, National Association of Stock Plan Professionals

cc: Hon. Christopher Cox, Chairman of the Securities and Exchange Commission
Hon. Cynthia A. Glassman, Commissioner
Hon. Paul S. Atkins, Commissioner
Hon. Roel C. Campos, Commissioner
Hon. Annette L. Nazareth, Commissioner