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Business Law Section
Committee on Securities Regulation

April 28, 2006

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

E-mail address: rule-comments@sec.gov

Attention: Nancy M. Morris, Secretary

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

Ladies and Gentlemen:

The Committee on Securities Regulation (the "Committee") of the Business Law Section of the New York State Bar Association appreciates the invitation in Release Nos. 33-8655, 34-53185; IC-27218 (the "Release") to comment on proposed amendments to the disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters and security ownership of officers and directors, under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940.

The Committee is composed of members of the New York Bar, a principal part of whose practice is in securities regulation. The Committee includes lawyers in private practice and in corporation law departments. A draft of this letter was reviewed by certain members of the Committee, and the views expressed in this letter are generally consistent with those of the majority of members who reviewed and commented on the letter in draft form. The views set forth in this letter, however, are those of the Committee and do not necessarily reflect the views of the organizations with which its members are associated, the New York State Bar Association, or its Business Law Section.

Summary

We commend the Commission's Staff for undertaking such a comprehensive review of the Securities Acts requirements regarding executive compensation, related party disclosure and associated matters. The Release has identified areas of possible weakness in current disclosures, and proposes many new rules and changes to existing requirements to address these weaknesses.

The Committee agrees with the Commission's objectives to make disclosure documents easier to understand, provide investors with a clearer and more complete picture of compensation earned, and provide better information about key relationships among companies and related persons.

We recommend that the Commission make certain changes to its proposals, as summarized below and discussed at greater length later in this letter, which we believe are necessary to make the proposed rules more effective, minimize confusion and permit practical and efficient implementation.

We applaud the Commission's goal of increased consistency of disclosure for all registrants while at the same time reflecting the inherent limitations of small issuers through the differences between proposed Item 402 of Regulation S-B and Item 402 of Regulation S-X. Similarly, we believe the Commission should formulate a *de minimis* exception to the disclosure requirements for immaterial items, which is consistent with the focus of the Securities Acts on providing investors with material information. In addition, we recognize that some of the Commission's proposals attempt to avoid duplication or unnecessary detail, but believe that other changes should be made to minimize the risk of overwhelming investors with disclosure overload.

We recommend that the deferred compensation should not include market-rate earnings; only above-market or preferential earnings should be disclosed and included.

We agree that the named executive officers should include the principal executive officer, principal financial officers and the three most highly compensated other officers. However, the selection of the three other NEOs should be based on salary and bonus, not on "total compensation" as proposed by the Commission. In addition, we urge the Commission to eliminate the proposed requirement for disclosure of up to three highly compensated employees who are not executive officers as not providing meaningful information to investors but disclosing possibly sensitive, competitive information to competitors.

We recommend that the additional policy information that would be provided in the proposed new Compensation Disclosure and Analysis section instead be included in the current Compensation Committee Report, which should be retained as "furnished" information. Only quantitative information on amounts of compensation, which is properly within the purview of management, should be provided by and possibly certified by management.

We believe that the Summary Compensation Table and the "total compensation" amount will be meaningful and useful only if its elements are properly valued and allocated among the relevant years. Accordingly, we urge that the Stock Awards and Option Awards (columns (f) and (g)) be allocated at the times (*i.e.*, for the years) and in the amounts recognized for financial reporting purposes. This means that for multi-year awards, the timing and amounts should be based on the treatment for financial statement reporting, instead of the proposal which would require disclosure of the entire aggregate FAS 123R grant date value. This recommended treatment should apply to awards with performance-based conditions as well. We suggest that the aggregate fair value of each award at grant is useful and would better be presented in the supplemental equity award tables.

Non-stock performance-based incentive awards in column (h) and the equity-based awards in columns (f) and (g) of the Summary Compensation Table should be presented on a consistent basis. This could be accomplished by showing in column (h) an estimate of the annual opportunity represented by a typical multi-year award, as discussed in detail below in Paragraph (5) of this letter. The amounts actually earned by each NEO once the performance period has ended could be shown by requiring that the information now proposed for column (h) be shifted over to the supplemental "Grants of Performance-Based Awards" table, as described below in Paragraph (5).

We believe that the most useful format for disclosure of performance targets would be to include all relevant information in one place -- the Performance Grants table.

We support the consolidation of the two columns presently used to disclose other compensation to the proposed All Other Compensation (column (i) in the Summary Compensation Table.) Furthermore, because of the difficulties in precisely valuing these types of items, we urge the Commission to provide a *de minimis* exception for inadvertent understatement of perquisites by less than the greater of 10% or $10,000.

We urge the Commission to modify the proposed requirement to show the increase in pension actuarial value in a manner, discussed in Paragraph (6) below, that would greatly simplify the disclosure and provide the information on a normalized basis for all reporting companies.

We support the additional clarity provided on transactions to be disclosed, the definition of "related person," and increasing the disclosure threshold while leaving the principle-based concept of whether the interested person has a direct or indirect material interest. However, the requirement in proposed Item 407(a)(3) to describe any transactions, relationships or arrangements not disclosed pursuant to Item 404(a) that were considered by the board in determining independence, should be eliminated.

In addition, the Commission should provide in adopting final rules that prior interpretations under which Directors are qualified as non-employee directors under rule 16b-3 would be maintained upon adoption of the proposed elimination of item 404(b).

Finally, we support the proposed changes to Form 8-K that would reduce the number of filings about executive compensation that are immaterial in nature or amount, and focusing on the PEO, PFO and the other NEOs.

Discussion

1. Disclosure of All Compensation --The Commission Should Provide A *de Minimis* Exception For Inadvertent Omission Of Immaterial Items Of Disclosure.

Deferred Compensation Should Not Include Market-Rate Earnings; Only Above Market Or Preferential Earnings Should Be Included And Disclosed.

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

In addition, market-rate earnings should not be included in deferred compensation. Only above-market or preferential earnings should be disclosed and included in compensation, as is the case under current requirements.

2. Persons Included in Summary Compensation Table--The Named Executive Officers Should Be The Principal Executive Officer, The Principal Financial Officer And The Three Most Highly Compensated Other Executive Officers Based On Salary And Bonus, Not On "Total Compensation" As Proposed In The Release.

Disclosure Should Not Be Required For Up To Three Highly Compensated Employees Who Are Not Executive Officers As Not Providing Meaningful Information To Investors But Disclosing Possibly Sensitive, Competitive Information.

The Commission's proposals include several changes from the existing rules for determining the named executive officers to be included in the Summary Compensation Table. We support the proposal that an issuer's principal executive officer and principal financial officer should always be included as named executive officers in the Summary Compensation Table (Regulation S-K 402(a)(3)). Regardless of their level of compensation, the PEO and PFO are the critical officers of any issuer, certifying financial and other disclosure, and disclosure of their compensation is meaningful to investors' analysis of the issuer and the performance of the members of the board of directors of the issuer standing for election. We do not believe that adding other officers by title or job function alone adds meaningful information to investors – for example, disclosing the compensation of a general counsel, who is not otherwise among the top

five most highly compensated executives, simply based on the position, would not provide material information to investors.

The identification of the remaining three NEOs under the Commission's proposals would be determined based on "total compensation" rather than on salary and bonus. If "total compensation" is determined as currently proposed (column (c) of the Summary Compensation Table) by aggregating the dollar values of the proposed remaining columns, the amount will include such items as the total value of non-vested multi-year stock and non-equity awards, increases in value of pension benefits and deferred compensation, and other items which are subject to annual variations which may not be tied to the executive's basic compensation for the year but rather to whether it is a grant year in a plan cycle, the executive's ability to defer income or the executive's age. (Note the changes in reporting options recommended in Paragraph (4), below.)While the value of other compensation is very significant, we believe that salary and bonus (inclusive of any amounts deferred by the executive) continue to be the leading indicators of an executive's perceived importance to the issuer. Limiting the pool of possible NEOs by salary and bonus also provides more consistency in the individuals included over the three years compensation disclosed in the Summary Compensation Table and balances the investors need for information with more reasonable record keeping requirements for issuers.

The proposal also would add to the compensation disclosure the total compensation and job descriptions of up to three employees who are not executive officers but whose total compensation for the year exceeded that of any of the NEOs. (Proposed Regulation S-K Item 402(f)(2).) The proposal indicates that this disclosure is designed to alert investors about the use of corporate assets to compensate individuals but would not require disclosing their names since they are not in policy making functions. We do not believe that this additional information adds materially to the total mix of information available to investors. Compensation expense for an issuer, as well as other expenses of its business, is disclosed in the financial statements. If the goal of the additional disclosure were to identify individuals or jobs within an issuer which are critical to its success, as measured in part by the high compensation paid by the issuer, the disclosure might be more useful as a risk factor disclosure in the Form 10-K where the nature of the contribution of the individual to the success of the issuer can be explained. Simply to disclose total compensation and job descriptions seems likely to result in disclosures which may be competitively disadvantageous to certain issuers, inconsistent from year-to-year, and require significant additional record keeping (since the elements of "total compensation" cannot be determine solely by looking at a W-2).

3. Additional Policy Information In The Proposed New Compensation Discussion and Analysis Should Be Included In The Current Compensation Committee Report, Which Should Be Retained As "Furnished Information;" Only Quantitative Information on Amounts Of Compensation, Which Is Properly Within The Purview Of Management, Should Be Provided By And Possibly Certified By Management.

The Commission's proposal to replace the current Compensation Committee Report with a Compensation Discussion and Analysis (CD&A) analogous to Management's Discussion and Analysis of Financial Condition and Results of Operations is creative and thoughtful. We

support the types of disclosures recommended in the proposal and the breadth of the disclosure suggested, particularly taking the CD&A disclosure (proposed Regulation S-K Item 402(b)) together with the additional proposed disclosures regarding the functioning of the compensation committee (proposed Regulation S-K Item 407(e)). Better and more comprehensive disclosure with respect to both the process of setting executive compensation by the compensation committee and the amount of such compensation will permit shareholders to better understand and evaluate the compensation policies and amounts of executive compensation.

Central to strengthening the integrity of the compensation committee's process in setting compensation for NEOs, however, is to require the compensation committee to take responsibility for the disclosure of its policies and procedures. The current proposal for CD&A removes the disclosure responsibility from the committee and places it on the very executives whose compensation is being disclosed. It may create confusion as to who sets the compensation of NEOs – the independent board compensation committee or those officers. We recommend that the proposed disclosures of the CD&A be integrated with the compensation committee report so that it is the compensation committee – the individuals making and interpreting the compensation policy – who describe it. The members of the compensation committee would seem to be the only individuals who could fairly describe the items required by the CD&A: the objectives of the compensation program, the behaviors and results the program is designed to reward, the reasons for paying each element of compensation, the policies for allocating compensation between long-term and current, etc. Management should provide the additional detail on the actual amounts of various elements of the compensation – the numbers in the table and the detail required in the new footnotes and narrative disclosures. That quantitative information could be subjected to the certifications of the principal executive officer and the principal financial officer.

4. Summary Compensation Table - Stock Awards and Option Awards (Columns (f) and (g)) For Multi-Year Compensation Should Be Allocated At The Times And Amounts Based On Financial Reporting, Instead Of The Grant Date Value.

One of the most important changes to the Summary Compensation Table is new column (c), showing total compensation earned and allocable to the reporting year by each NEO from all sources, on a year by year basis, regardless of whether the compensation is deferred or, in the case of equity awards, earned or monetized at a later date. In order for the total compensation number to be meaningful, however, and for comparisons between NEOs at different companies to be useful, the items reported in all other columns of the Summary Compensation Table still need to be fairly allocable to the year for which the aggregate is being calculated. For this reason, we do not think that the entire aggregate FAS 123R grant date value of each Stock Award should be included, where the award was intended as compensation for multiple years of service, *i.e.*, over the vesting period.

Requiring that equity awards be reported in this manner would distort the annual compensation total shown in column (c), because the aggregate grant date value of an equity award bears no relationship to either the actual amount included in income or the allocable portion of the award that was intended as compensation for the year in which the grant was made. It would also undermine the purpose served by requiring disclosure of total compensation since, if the proposed method of reporting equity grants were followed, the total

compensation number would not in any sense be a true reflection of annual compensation, unless it were adjusted to back out this distortion.

Instead, we recommend that equity awards be disclosed in the Summary Compensation Table at the same time, and in the same amounts, as they are recognized for financial statement reporting purposes. We do not think any purpose would be served by allowing use of valuation methodologies that are different from those used for financial reporting purposes. Every company must now measure and allocate this expense using the FAS 123R rules. However complex these rules may be to apply to the features of a particular grant, they are the reference point that all companies must follow. While we recognize that the compensation committee may look at the grant date fair value in making decisions on granting awards, we believe that the approach based on financial statement reporting is appropriate for the purposes of the Summary Compensation Table. We think it is far preferable to apply a single set of rules that evolved with the benefit of years of thoughtful debate, than to introduce an entirely different method of reporting the cost of equity awards. We think that another drawback to showing grant date fair value as a measure of "annual" compensation, is that it will force every company to try to sort out the confusion, in what will likely be non-uniform ways, through the use of the required supplemental tables and footnotes, and prescribed narrative explanations.

One benefit of the approach we are suggesting is that it would give a much more accurate picture of the true cost of multiyear, overlapping grants. When a company makes recurring annual grants that vest over multi-year periods, the portion of *each* grant that vests in the reporting year (whether originally made in the current or prior years) would still have to be cumulated and included in compensation for that single year.

Although showing the aggregate fair value of each award at grant is useful information, we think a better place to present that information would be in the supplemental equity award tables. If this approach is followed, the supplemental equity tables should be amplified to show the total potential value realizable at grant (based on aggregate FAS 123R grant date fair value), and the value actually realized (*i.e.*, includable in income), as a result of vesting or exercise. Since options and other equity awards derive their ultimate value over periods that are often longer than three years, footnote disclosure of original grant date fair value could be shown in the case of awards that were granted more than three years earlier than the date income is realized.

Disclosure of stock-based awards with performance-based conditions should be handled under columns (f) and (g) in the same fashion. If the nature of the performance condition is one that results in the award or option being expensed for financial reporting purposes over the implied service period over which services will be performed, then the portion of that expense that is properly allocable to the reporting year should be reflected in the Summary Compensation Table on the same basis as other stock-based grants, regardless of whether the performance conditions have been satisfied. The supplemental equity award tables should similarly be adapted to require that grant date fair value be shown, as well as the value actually realized from equity awards with performance conditions, once the performance conditions have played out, so that any understatement or overstatement of compensation attributable to showing the aggregate grant date value of equity awards with performance conditions will be readily apparent.

5. Summary Compensation Table - Non Stock Performance-Based Incentive Awards (column (h)) And The Equity-Based Awards In Columns (f) and (g) Of The Summary Compensation Table Should Be Presented On A Consistent Basis By Showing In Column (h) An Estimate Of The Annual Opportunity Represented By A Typical Multi-Year Award,

Amounts Actually Earned By Each NEO Once The Performance Period Has Ended Could Be Shown By Requiring That The Information Now Proposed For Column (h) Be Shifted Over To The Supplemental "Grants of Performance-Based Awards" Table,

There is a fundamental inconsistency in the Proposal's requiring that the full grant date fair value of equity-based performance plans be reported in the year of grant, while deferring the reporting in the Summary Compensation Table of non-stock performance-based compensation until the compensation is earned. The stated rationale for differentiating the treatment of these two similar types of awards, -- that there is no clearly accepted or required standard for valuing the non equity-based award at grant -- lends some support to the inconsistent treatment. We think this rationale becomes less compelling, however, if the recommendation in Paragraph (4) above regarding multi-year equity-based plans is accepted.

If the Summary Compensation Table were to require that the allocated annual expense for FAS123R purposes be used as the measure of value for an equity grant, fully accepting that it will not precisely correspond to the income ultimately recognized, then a more consistent treatment of equity-based and non-equity based performance opportunities might be achieved by showing in column (h) an estimate of the annual opportunity represented by a typical multi-year non-stock incentive award. This opportunity could be measured, either by reference to the total target opportunity divided by the years in the performance period, or by using the allocated annual accounting expense. Using total target opportunity divided by years in the performance period may be more appropriate, since it presumably reflects the compensation committee's best judgment as to the amount of compensation that will be paid if the target performance objectives are precisely achieved.

If column (h) were revised to use the approach suggested, it would still be important to show the amount actually earned by each NEO once the performance period has ended. This would require that the information now required to be shown in column (h) be shifted over to the supplemental "Grants of Performance-Based Awards" table, and that the caption be changed so that it references both grants, using the format suggested, and the amount ultimately earned.

Following this approach would have at least two advantages. First, it would be more consistent with requiring each reporting company to show the total annual compensation awarded to its NEOs. In the case of long-term compensation, the Summary Compensation Table can either show the best estimate of the compensation opportunity, and allocate that opportunity to the reporting years covered by the table, or defer disclosure until all events have occurred and collapse all of the income from the grant into one year. We think the better choice is to show an estimate of the allocated annual opportunity, in the case of both equity-based and non equity-based grants.

The second advantage is that it would allow for presentation in one place, *i.e.*, the suggested Grants and Earned Performance-Based Awards table, of not only the information required by the proposal (amount payable at threshold, target and maximum), but also of how much was ultimately paid out with respect to that award. This begins to provide critical insights

as to whether there is a pattern of payments made, relative to the amount of the original target award, particularly if the narrative disclosure now required by item 402(f)(iv) of the proposals (of any waiver or modification of any specified performance target) were to be repositioned so that it is shown as a footnote to the amount actually paid.

We think that the most useful format for disclosure of information about a company's performance targets would be for the Performance Grants table to include all relevant information in one place, so that investors would have the tools to assess the integrity of the compensation process.

6. Summary Compensation Table -We Support The Consolidation Of The Two Columns Presently Used To Disclose Other Compensation To The Proposed All Other Compensation Column (i))

We urge the Commission to provide a *de minimis* exception for inadvertent understatement of perquisites by less than the greater of 10% or $10,000.

We Urge The Commission To Adopt The Method Discussed Below To Show The Increase In Pension Actuarial Value Which Would Greatly Simplify The Disclosure And Provide The Information On A Normalized Basis For All Reporting Companies.

We support the consolidation of the two columns presently used to disclose other compensation, and applaud the helpful guidance that has been provided for disclosure of perquisites. Given the difficulties in precisely valuing items of this nature, however, we urge that a *de minimis* exception be provided so that there would not be a reporting violation if the aggregate value of the perquisites has been inadvertently understated by less than, *e.g.*, the greater of 10% or $10,000.

We think the requirement to show the increase in pension actuarial value should be retained but can be greatly simplified, given the extensive disclosure that is required under the new Retirement Plan Table. Regarding that table, it should be sufficient, and would normalize the disclosure for all reporting companies, to require disclosure for each NEO of the projected value of the retirement benefit under each plan, at the earliest age at which an unreduced benefit is payable, in the form of benefit that has the highest value ("Highest Value"), rather than showing both the early retirement and normal retirement benefit, in the form then currently elected by that NEO, since an NEO will typically elect the form of benefit that has the highest value, which is normally the lump sum if that form is available. To determine the annual increase in pension value for purposes of the Summary Compensation Table, it should be a sufficiently close approximation to divide the Highest Value, for each NEO in each plan, by the shortest number of years of service that it takes under that plan for that NEO to earn a benefit equal to the Highest Value, disregarding future compensation increases.

7. Related Party Transactions -- We Support The additional Clarity Provided On Transactions To Be Disclosed, The Definition Of "Related Person, "And Increasing The Disclosure Threshold While Leaving The Principle-Based Concept Of Whether The Interested Person Has A Direct Or Indirect Material Interest.

The Requirement In Proposed Item 407(a)(3) To Describe Any Transactions, Relationships Or Arrangements Not Disclosed Pursuant to Item 404(a) That Were Considered By The Board In Determining Independence Should Be Eliminated.

The Commission Should Provide In Adopting The Final Rules That Prior Interpretations Under Which Directors Are Qualified As Non-Employee Directors Under Rule 16b-3 Would Be Maintained Upon The Proposed Elimination of Item 404(b).

The disclosure contemplated by proposed item 407(a)(3) regarding matters not required to be disclosed under Item 404 could result in the disclosure of immaterial information in disclosures which are in risk of being overloaded, and would in addition be inconsistent with categorical standards of independence under NYSE Listed Company Manual.

The elimination of current Item 404(b) may lead to interpretive issues, particularly with respect to the status of "Non-Employee Directors" under Section 16 of the Exchange Act. Rule 16b-3(b)(3)(i) currently includes reference to relationships that would require disclosure under Item 404(b) in the definition of a "Non-Employee Director." Non-Employee Director is a critical determination for purposes of the exemption under Rule 16b-3 involving certain transaction with the issuer approved by a committee composed solely of two or more Non-Employee Directors. The Commission should expressly provide in the rules adopted that prior interpretations under which directors are considered Non-Employee Directors would be maintained upon adoption of the proposed change regarding 404(a) and (b).

8. Amendments to Form 8-K.

We commend the Commission for proposing the changes to Form 8-K to focus on the timely disclosure of material information about executive compensation while reducing the number of filings disclosing information which affects the compensation of executive officers but is immaterial in nature and/or amount. Removing from Form 8-K Item 1.01 the disclosure of agreements and amendments described in Regulation S-K Item 6.01(b)(10)(iii)(A) or (B) and adding subsection (e) to Form 8-K Item 5.02 will focus the filings on disclosure of material compensation changes affecting the principal executive officer, the principal financial officer and the other NEOs – not all executives whether or not material in substance or amount. We recommend that the safe harbor under Section 10(b) and Rule 10b-5 apply to the failure to file a report on Form 8-K for matters within Item 5.02(e), as it did when the similar disclosure was required under Item 1.01.

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We hope the Commission finds these comments helpful. We would be happy to discuss these comments further with the Staff.

Respectfully submitted,

COMMITTEE ON SECURITIES REGULATION

By Michael J. Holliday
MICHAEL J. HOLLIDAY
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