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April 10, 2006

Via email (to rule-comments@sec.gov)

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

Re: File Number S7-03-06; Proposed Amendments to
Executive Compensation and Related Party Disclosure Rules

Dear Ms. Morris:

This letter sets forth the comments of Steven Hall & Partners regarding the proposals of the Securities and Exchange Commission (the "SEC") relating to executive compensation, as set forth in Release No. 33-8655 (January 27, 2006) (the "Proposing Release"). Steven Hall & Partners is a consulting firm which advises corporations and compensation committees regarding compensation of executives and directors. The firm was established in 2005 by Pearl Meyer, Steven Hall and Steven Root, who combined have more than 75 years of experience in advising public companies with respect to executive compensation.

We commend the SEC for proceeding with this initiative. We fundamentally agree that corporate stakeholders and potential investors deserve disclosure of executive compensation that is complete, transparent, comparable from year to year, and comparable from company to company.

Proposed Item 402(a)/402(f)(2)

Making the principal financial officer ("PFO") a *per se* named executive officer ("NEO") is reasonable, and determination of the three other most highly compensated NEOs based on total compensation offers some benefit by eliminating the need for strict rules as to what constitutes annual versus long-term term compensation in the Summary Compensation Table. However, amounts that do not primarily reflect compensation paid based on a determination of the compensation committee or board should be excluded from the "total compensation" that determines who will be among these three NEOs, particularly earnings on elective deferred compensation and actuarial valuation increases that are greatly affected by the executive's age.

We understand that some commentators have suggested broadening the definition of executive officer. We oppose this idea, as the current definition is well understood and (except for one circumstance) corresponds with the definition of "officer" under Rule 16a-1(f).

We oppose the proposal in proposed Rule 402(f)(2) that total compensation be provided on a no-names basis for three non-executive officers. While this could result in interesting data about celebrity employees or high-producing employees, the information would not be relevant to assessing the performance of the Board or compensation committee, which may or may not have a role in setting such compensation. In some cases, this disclosure will make it harder for companies to hire and retain key employees, and could cause internal friction within the organization. These disadvantages outweigh any benefit to stakeholders or potential investors from disclosure of this information.

Instruction 4 to Item 402(a)(3) seems to provide that, if an executive officer were promoted to be Principal Executive Officer ("PEO") or PFO in fiscal 2008, the Summary Compensation Table in the 2009 proxy statement would not show his or her compensation for fiscal 2006 and fiscal 2007. If an executive officer first became a named executive for fiscal 2008, Instruction 4 apparently would require fiscal 2006 and fiscal 2007 disclosure. Three years of compensation information should be shown in all of these cases.

Item 402(b) – The Compensation Discussion and Analysis

Based on our long experience assisting in the drafting of compensation committee reports, we see the proposed Compensation Discussion and Analysis ("CDA") as no real improvement. Even acknowledging that many current compensation committee reports are of poor quality, we have seen improvement in recent years as compensation committee members have taken increasing responsibility for the report. We would make the following recommendations:

- Retain the report as a report of the compensation committee to stockholders, signed by members of the compensation committee.
  The PEO and PFO should not sign the report. Under good corporate governance principles and NYSE and Nasdaq rules, the PEO and PFO should not be privy to Committee deliberations on their compensation. In any case, the PEO and PFO remain responsible for all other compensation disclosures, which are incorporated by reference into the Form 10-K. If the SEC would like to increase the focus of the PEO and PFO on these disclosures, consider beefing up the existing certification process. Obviously, a certification by a PEO or PFO that is faulty due to bad disclosure of the PEO's or PFO's own compensation would present a compelling case for enforcement. The SEC could point this out to achieve the desired effect without confusing the discussion in the CDA by making it a joint statement of the committee and two executive officers.
- The compensation committee report should continue to be furnished rather than filed, precisely because it should not be covered by a PEO and PFO certification. We do not agree that the SEC's original rationale for having the report be "furnished" was incorrect (to encourage open communication from the committee

to stockholders). As discussed above, we believe that reviews and perceptive comments from the SEC staff would lead to improvement in these reports much more so than a greater threat of litigation. A key weakness of current compensation committee reports is that they are not written by committee members; adding to the risk of liability will only further shift responsibility for the report to lawyers and professionals and away from the committee members.

- Proposed Item 402(b) gives a laundry list of topics to be covered by the CDA, which experience shows will lead to boilerplate. In particular, current compensation reports often devolve into scattershot discussions of the specific components of compensation, but fail to answer the key question: Why did the Committee authorize the payment to the PEO and other executive officers of the amounts of compensation it authorized.
- The proposed laundry list is too focused on components and not focused enough on total compensation. For those committees that have adopted tally sheets and a more rigorous approach based on total compensation, writing a CDA to meet the new laundry list will represent a step backwards. Instead of a laundry list of topics, Item 402(b) should clearly and concisely ask for an explanation of why the committee is authorizing payment of the amounts of total compensation it is paying, and what it is trying to accomplish by paying each component of total compensation.
- Item 402(b)can and should ask for detail as part of the explanation of these fundamental questions. We recommend that the report explain the Committee's compensation philosophy and explain how any peer groups have been identified and used in setting compensation, marketplace positioning of total compensation and specific components of compensation against peer groups or other measures of market practice, and the relationship between total compensation and individual compensation components and company performance.
- The CDA or report should address only the last completed fiscal year. As an alternative, it could also address any decisions for the current fiscal year, particularly if the Form 8-K is no longer to be used for disclosures of routine compensation program actions (as we suggest below).

Item 402(c) – The Summary Compensation Table

The Summary Compensation Table ("SCT") needs to present information in a way that is relatively simple, comparable from year to year, comparable from company to company, picking up all significant compensation and avoiding double counting. The proposed SCT falls short of meeting these objectives. The main problems with the proposed SCT are:

- It mixes amounts that represent award "opportunities" with amounts of compensation "realized" during a fiscal year.
- It fails to allocate expense for awards over multiple years in the performance or service period required under the award; for some awards, the SCT crams all expense into the grant year and for others (non-stock incentive plan compensation) expense is shown in the year performance conditions are met.
- For performance-based awards valued in the year of grant, the SCT has no effective way to value awards based on the amount earned or likely to be earned.

Three basic approaches to the SCT can be envisioned:

- Show compensation “opportunities” authorized for a given fiscal year.
- Show compensation “realized” for the fiscal year (disregarding deferrals no longer subject to a risk of forfeiture).
- Show amounts recognized as accounting for compensation expense for the fiscal year.

Blending these three approaches in one table would be confusing and not helpful to stakeholders or investors. However, showing different amounts in different tables would provide useful perspectives on the executive compensation program.

We suggest that the Summary Compensation Table be presented in two versions, the first showing “opportunities” and the second showing “amounts realized”:

- In the “opportunities” table, awards that vary based on performance would be shown at target levels and maximum levels. If awards could be earned for below target performance, footnote disclosure should be required. For open-ended performance awards with no absolute maximum level, a reasonable estimate of the maximum level would be required.
- Some items, like salary and “All Other Compensation” amounts, should be the same in both tables.
- In the “opportunities” table, equity awards should be valued in accordance with FAS 123R, but dividends and dividend equivalents should not be counted as separate compensation because FAS 123R takes them into account when assessing fair value. The exception would be if dividends or dividend equivalents are paid on a non-forfeitable basis prior to vesting of the underlying award, which amounts should be shown by footnote.
- An “opportunities” table would address a key problem with the SCT in the Proposing Release and under the current rules, which (apparently) require that performance-based equity awards be shown at the maximum payout level. If the SEC does not accept the idea of a clearly labeled “opportunities table,” it still needs to address how performance-based equity awards (including options with a performance condition) will be shown in specific tables (like the current rules, the proposed rules are very unclear on this point). We suggest that for any table not specifically showing opportunities labeled as “maximum,” the award value shown be based on the greater of the “target” level or the probable level of earning estimated for accounting expense recognition purposes as of the end of the fiscal year. An instruction is also needed requiring a reasonable estimate of the maximum award level for open-ended performance-based awards that have no absolute maximum. Showing performance shares in the tables at maximum levels would distort the value of the award. In contrast, options have the potential for realized gains far in excess of the cost reflected in the compensation tables, but are valued under FAS 123R at an approximation of grant-date value, not maximum value.
- The “opportunities” table should provide supplemental information (in footnotes or accompanying text) regarding each type of performance-based award. Ideally, a tabular presentation would explain, for each type of award, its purpose, the range of opportunity versus performance, the period over which performance is measured, any additional vesting terms, the expected frequency of grants of this type of award, eligibility and participation , the form and timing of payments, and termination provisions.

- The “realized” table should show the value of compensation actually paid or which has become non-forfeitable. For stock-based awards, the value should be shown at the date of vesting (lapse of the risk of forfeiture), without regard to any further periods of deferral (mandatory or elective). It would be consistent, to show the realized value of options as their fair value at the date the risk of forfeiture lapses, rather than the value realized at the date the executive chooses to exercise the options. However, the traditional approach (in the current rules) is to show the value realized by exercise of options.
- Footnote disclosure should be required under the “realized” table with respect to tax deductions that are lost due to payment of specific items of executive compensation. Specifically, if compensation is paid that is non-deductible under IRC Section 162(m), a footnote should indicate the amount that was non-deductible and the approximate amount of income tax that would not have been paid had the compensation been deductible. This information is important (i) for an understanding of the overall cost of the executive compensation to the Company (particularly because it can be assumed that most compensation results in a corresponding tax deduction), (ii) to assess the quality of the decision-making of the compensation committee, and (iii) because shareholders play an important role under IRC Section 162(m) in approving material terms of compensation as a condition of preserving tax deductibility, and therefore should be given information to help them perform this function. Item 402(c) should also explicitly require footnote disclosure regarding lost company tax deductions relating to use by executives of corporate aircraft and any other perquisite not fully deductible as an expense of the company, in order for stakeholders to understand the true cost of permitting such aircraft use and other perquisites.
- The total compensation column should be moved to the far right for the Summary Compensation Tables.
- We support the use of incremental cost as the measure of expense for perquisites. In 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.
- Assessing the value of equity awards at fair value under FAS 123R makes sense, but when awards are granted in exchange for other awards the fair value of the surrendered award should be netted against the fair value of the new award, as under FAS 123R. The SEC disclosure rules should not be used to discourage repricing (as for example the SEC staff has done with the issuer tender offer rules). To create special disclosure rules that require double counting in the compensation tables is not consistent with the reliance otherwise placed on FAS 123R valuations.
- Consider whether some disclosure of the amount of expense recognized for accounting purposes for a given fiscal year should be presented, possibly in a footnote. As the SEC knows, the accounting rules have developed as a comprehensive system to accurately recognized expense, and there is no question that they shape decision-making on executive compensation.

If the SEC adopts the new rules by September 30, 2006, consider requiring full compliance for all three fiscal years shown in Summary Compensation Tables for issuers with a fiscal year ending after December 15, 2006. Otherwise, the lack of comparable information for earlier years shown in the table will reduce the value and relevance of the new disclosures to stakeholders and potential investors.

Performance Graph

- The Performance Graph provides a helpful reference for assessing overall company performance. It is not burdensome to produce. We recommend that it be retained.

Form 8-K Amendments

- The proposal to cut back on the Form 8-K requirements for disclosures relating to compensation, in connection with the adoption of much improved proxy disclosure of compensation is well advised. A review of the proposing and adopting releases for the Form 8-K rules makes it clear that the SEC and its staff did not recognize the effect Form 8-K would have on executive compensation disclosure. That disclosure of executive compensation has needed improvement has long been obvious, but the problems go to completeness, transparency and comparability of the disclosures. The Form 8-K rules addressed the wrong problem, providing for very quick but unstructured disclosure. How to apply the material contracts disclosure rules of Item 601(b)(10) to Form 8-K has been a major mystery and, while we appreciate the issuance of an FAQ by the SEC staff, it remains difficult to discern the staff's concept of what must be disclosed in Form 8-K. (Example: A million-share option grant that uses the standard company form option agreement does not trigger disclosure, but according to some lawyers a small increase in the CEO's salary triggers an 8-K).
- We suggest that the proposed Item 5.02 of Form 8-K be revised to be even narrower, limited to new or materially amended employment contracts, severance agreements, and change in control agreements, and not covering equity awards and incentive plans. Equity awards and incentive plans are routine and repetitive items; an 8-K should not be triggered simply because the company adds a non-solicitation provision or provides for three-year vesting this year as compared to four-year vesting last year. These documents, if they have materially changed, should be filed as exhibits with the Form 10-Q for that quarter. Certainly, it makes no sense to require a company to file a Form 8-K to announce that stockholders have approved a new equity compensation plan, for which thorough disclosure would already have appeared in the proxy statement.
- The Form 8-K requirement is currently burdensome on companies, particularly in-house counsel. Perhaps the greater part of the burden is the legal uncertainty as to what triggers a Form 8-K filing. The SEC should direct the staff to issue clear interpretations that ensure that Form 8-K is filed only for matters that are unquestionably or presumptively material.

Outside Director Compensation

We suggest that perquisites for non-employee directors need not be subject to a $10,000 threshold level for disclosure. The current rules appear to require disclosure of any amount of perquisites, at least to the extent of explaining of the company's standard policy for providing the perquisites. Identifying and quantifying all perquisites for non-employee directors should not be unduly burdensome.

Corporate Governance Disclosure

Proposed Item 407(e) would require disclosure regarding the role of a compensation consulting firm, including:

> Any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying such consultants, stating whether such consultants are engaged directly by the compensation committee (or persons performing the equivalent functions) or any other person, describing the nature and scope of their assignment, the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement and identifying any executive officer within the registrant the consultants contacted in carrying out their assignment.

This requirement is too intrusive, in our view. While there is nothing wrong with formality in the relationship between consultants and the compensation committee, this disclosure requirement threatens to elevate any divergence between a consultant's recommendation and a compensation committee's decision to the level of a disagreement between a company and its auditors. Even if that kind of disclosure were not required, if a compensation committee does not follow a consultant's recommendation, the naming of the consultant in the proxy statement potentially could give stakeholders and potential investors the mistaken impression that the consultant concurs in the decisions of the compensation committee. If these disclosures are incorporated by reference into a registration statement under the Securities Act of 1933, the consultants may be deemed to have provided expert advice, giving rise to unintended liability.

Consultants typically have detailed discussions with a broad range of executives, particularly when providing pricing information on executive jobs. In any case, it would be unusual if consultants did not have discussions with the PEO, PFO, General Counsel and Head of Human Resources of any company. So, a listing of executive officers consulted will not provide useful information to stakeholders. Likewise, disclosure of the "material elements of instructions and directions" will have a chilling effect on communications between consultants and compensation committees. We are not saying that attorney-client privilege attaches to such communications, but consultants do function as advisors to boards and committees, and rigid disclosure rules will only make it more difficult for the committee to ask for and receive good and candid advice.

A good deal of compensation related advice is provided to compensation committees by legal counsel. In those cases, this disclosure requirement would appear to compel disclosure of what might otherwise be privileged information. Would the SEC require this same type of disclosure of advice given by legal counsel to a nominating and corporate governance committee?

The proposal does not explicitly address the important issue of the independence of the compensation consultants. Requiring that kind of information would be more in keeping with the SEC's approach to disclosures regarding the relationship between companies and professionals, such as auditors.

SEC Role in Compensation Disclosure

There has been much commentary in recent years about the lack of transparency in executive compensation disclosure, including criticism of executives, compensation committees, compensation professionals, and management and outside professionals who assist companies in preparing disclosures and administering compensation programs. We believe the SEC has earned a share of the criticism as well, an understanding of which could lead to improved disclosure rules and better disclosure for stakeholders and investors. So, we offer the following recommendations for consideration by the SEC and its staff:

First: Provide specific guidance. Shortly after release of the 1992 amendments to the proxy disclosure rules, the SEC staff put out a detailed release pointing out both good and bad examples of compliance and containing numerous interpretations. Since then, there has been very little guidance on Item 402, limited to two interpretive letters, published telephone interpretations (poorly edited and containing so much out-of-date material as to be nearly incomprehensible), and annual question and answer sessions with the Joint Committee on Employee Benefits of the ABA.

Detailed guidance is critical in order that the vast majority of companies adhere to high disclosure standards. Companies, when facing a disclosure issue for which there is no "controlling legal precedent," may not opt for transparency and disclosure. By addressing specific issues and giving clear guidance, the SEC and its staff will promote greater disclosure, better disclosure, and more uniform disclosure. This seems obvious, but the staff at times has avoided giving clear guidance, perhaps with a view to preserving its latitude to claim an even stricter legal position in some future enforcement action.

Perquisites provides a good illustration of this problem. At page 43 of the Proposing Release, the SEC states:

> For decades questions have arisen as to what is a perquisite or other personal benefit required to be disclosed. We continue to believe that it is not appropriate for Item 402 to define perquisites or personal benefits, given that different forms of these items continue to develop, and thus a definition would become outdated. Further, we are concerned that sole reliance on a bright line definition in our rules might provide an incentive to characterize perquisites or personal benefits in ways that would attempt to circumvent the bright lines.[111]

Footnote 111 recounts how in 1983 the SEC rescinded the only interpretive guidance on perquisites it had ever issued, and states: "Subsequently, neither the Commission nor its staff has published interpretations addressing what must be disclosed as a perquisite or personal benefit."

This is the wrong approach, in our view. The SEC position seems to be that, while perquisites disclosure has been poor, specific guidance has been withheld to avoid a potential future claim that a new form of perquisites is not disclosable because it is not mentioned in the guidance provided.

In 2003, the ABA Joint Committee on Employee Benefits asked the staff whether it was acceptable to measure the "incremental cost" of personal use of company aircraft based on IRS imputed income rates. The Committee reported this SEC staff response:

> It should be valued based on the incremental cost to the company. As to whether the tax tables can be used as a proxy for incremental cost, the Staff would need to better understand the basis for the tax table amounts.

Two years later, the SEC brought an enforcement action against Don Tyson which established that the SEC does not regard IRS tax rates as a good measure of incremental cost. The SEC confirmed this point in the Proposing Release. A specific staff response in 2003 could have fixed one of the major problem areas in perquisites disclosure.

Second: Adopt specific rules. There appears to be no need to wait for a future interpretive release to give concrete guidance. For example, the proposed rules do not require disclosure of the amount of lost tax deductions resulting from executive compensation, except perhaps as part of some more abstract requirement. As discussed above, it would be far more transparent if the rules plainly require disclosure of the amount of taxes paid or payable because a tax rule limits tax deductions for executive compensation. Current rules require disclosure only of the compensation committee's "policy" regarding preserving tax deductions under Section 162(m) of the Internal Revenue Code. Similarly, regarding disclosure of the cost of change in control payments, state whether or not disclosure is required of the potential lost Company tax deductions if the golden parachute excise tax is triggered.

Third: In the event of an omission or lack of clarity, amend the new rules promptly to correct the problem rather than adding a gloss in an obscure location. Section 162(m) is a good example. The requirement that the compensation committee report disclose its policy under 162(m) is hidden in an obscure release from 1993. Indeed, this requirement was so obscure that the SEC and its staff appear to have forgotten about it in issuing the Proposing Release.

Fourth: Develop an approach to move companies toward better disclosure other than through enforcement action. In theory, staff reviews of proxy statements should help achieve this, but in our experience perceptive staff comments relating to executive compensation disclosure have been rare over the years. Rather than review entire filings, the use of FAQs and limited reviews of a larger number of proxy statements, focusing on particular areas of disclosure, would be a better way to promote improved disclosure.

Again, we urge that the staff examine its assumption that enforcement actions are the key tool for improving disclosure. In fact, they are isolated events and unfold very slowly. There was public awareness of the Tyson investigation for nearly two years before any litigation release became publicly available.

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We appreciate the opportunity to comment on these proposals, and would welcome the chance to discuss our comments with you. Please call me at (603) 526-4770 if you would like to discuss these comments.

Very truly yours

/s/ Steven C. Root
Steven C. Root
Managing Director