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SECURITIES LAW UPDATE

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Proxy Season Is Here! Another Look at the SEC Staff's Observations Regarding Executive Compensation Disclosure

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Last fall the Securities and Exchange Commission's staff in the Division of Corporation Finance (the "Staff") completed a review of the executive compensation and related disclosure of 350 public companies under the SEC's new and revised rules relating to executive compensation disclosure. As we are now in the midst of proxy season, it is helpful to review and consider the Staff's key observations and suggestions for improving compliance. A copy of the full report may be found at:

www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm.

Two principal themes emerged from the Staff's reviews and individualized comments to the companies whose proxy statements it reviewed. First, companies should provide more focused disclosure of how and why they made specific executive compensation decisions. Second, the manner of presentation is important, and companies should use it to provide more direct, specific, clear, and understandable executive compensation disclosure.

Manner of Presentation/Format

Companies could improve the manner in which executive compensation disclosure is presented by incorporating the following suggestions into their compensation disclosures:

- Emphasize material information and de-emphasize less important information.
- Emphasize in the Compensation Discussion & Analysis ("CD&A") section how and why compensation levels

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were established and de-emphasize and shorten lengthy discussions of compensation program mechanics.

- Place the required compensation tables after, not before, the CD&A, so that the CD&A serves as an overview of the compensation tables.
- Use charts, graphs, and tables, even when not specifically required by the rules, if they add clarity to the disclosure (the Staff found potential payments upon termination or change-in-control tables to be particularly useful; totaling such payments is suggested).
- Ensure that any alternative summary compensation tables used in conjunction with the required tables are not confusing and do not overshadow or detract from the required tables.
- Eliminate boilerplate language and replace it with discussion specific to a company's own facts and circumstances.

Performance Targets

The Staff issued more comments on performance targets than on any other disclosure topic, suggesting that this is an area on which companies should focus particular attention. The Staff had these suggestions:

- Clearly explain how qualitative inputs were translated into objective pay decisions and how individual performance was taken into account. The CD&A is not required to provide assessments of purely objective or quantitative criteria.
- In evaluating the need for performance target disclosure, a company's initial step is to determine whether a specific corporate or individual performance target is a material element of its compensation policies and decisions.
- If the performance target is material but is not disclosed, the company should (1) be prepared to demonstrate in detail how disclosure of the target would cause the company competitive harm, and (2) discuss how difficult or likely it will be for the undisclosed target to be achieved.
- To the extent a company believes its explanation of competitive harm provided to the Staff should receive confidential treatment, it should consider providing the

programs.

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explanation to the Staff on a supplemental basis, together with a request for confidential treatment.

- Disclose prior-year and/or current-year performance targets and/or achievements if it is material to an understanding of the compensation decisions for the last fiscal year.
- If the company presents a non-GAAP financial figure as a performance target, the company should disclose how that figure is calculated.

Compensation Discussion and Analysis

In the CD&A section, companies should enhance their analyses of compensation policies and discussions in the following manner:

- Focus the CD&A presentations on the substance of the company's compensation decisions and disclose *how* the company analyzed information and *why* its analysis resulted in the compensation the company paid. This does not mean that disclosure needs to be longer or more technical; indeed shorter, crisper, and clearer would often be better.
- Discuss the extent to which the amounts paid or awarded under each compensation element affected the decisions made regarding amounts paid or awarded under other compensation elements.
- Discuss policies and decisions for individual named executive officers that are materially different than for the other officers separately from group policies and decisions.
- Provide sufficient disclosure as to how benchmark compensation information was used and how it affected compensation decisions. Identify the companies included in the benchmark peer group. If the company states that it used comparative compensation information, but retained discretion on how to use it, then it must discuss the nature and extent of that discretion and whether or how it exercised that discretion.
- Disclose the rationale behind the material terms of termination arrangements and how these arrangements influenced other compensation elements, if applicable.

Corporate Governance

- Identify the parties involved in the compensation

process, including who made compensation decisions. Describe the role of executive officers in determining or recommending the amount or form of compensation, especially that of the chief executive officer.

- Be specific and comprehensive in the disclosure related to the use of compensation consultants by including the nature and scope of the consultant's assignment and material instructions provided to them by the company.

Other Staff Suggestions

- In the compensation tables, disclose all assumptions used in valuing option awards in the footnotes to the tables or by providing an appropriate cross-reference to the discussion of the assumptions elsewhere in the company's filing.
- In the compensation committee reports, be certain to include all information required by the rules, including a statement as to whether the compensation committee reviewed and discussed the CD&A with management.
- In the related-person transaction disclosure, provide a statement as to whether the company's policies and procedures for the review, approval, or ratification of related-person transactions are in writing, and if not, explain how these policies and procedures are evidenced.

In light of the Staff's observations, companies should review their disclosure from the 2007 proxy season and carefully examine how executive compensation decision-making was described. As compensation committees begin considering and evaluating executive compensation for 2008, they should focus on how and why they are making their decisions at the time the decisions are being made and should consider the resulting disclosures that will be required in the proxy statement. In addition, management should consider providing a summary of the Staff's observations to the compensation committee so that the members are informed about the disclosure obligations related to their executive compensation decisions.

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