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CORPORATE ADVISOR

SEC Observations in the Review of Executive Compensation Disclosure

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Overview

On October 9, 2007 the Securities and Exchange Commission staff (the "Staff") issued a report summarizing the key executive compensation disclosure issues unearthed in its review and analysis of the filings of 350 public companies. The following is a summary of the Staff's evaluation of the level of compliance with its revised rules for executive compensation disclosure achieved by the sample. The revised rules became effective November 7, 2006 and were amended December 21, 2006 to address specific issues pertaining to how public companies should disclose stock and option award compensation, related party transactions and corporate governance issues.

The SEC observations are intended to assist companies improve their disclosure for the 2008 proxy season.¹

Two Principal Themes

Two principal themes emerged from the SEC's review of these select companies. First, a company's Compensation Discussion and Analysis ("CD&A") must focus on how and why a company arrives at a specific executive compensation decision. The Staff clarified that this does not mean disclosure should be longer or more technical, in contrast, it encouraged companies to use shorter, crisper and clearer sentences.

Second, the Staff emphasized the importance of adhering to plain English principles and organizing tables and graphs in a way that enhances the reader's understanding of the disclosure. Similarly, certain techniques such as providing an executive summary and including tables and charts tailored to a company's specific executive compensation program can significantly enhance the value of the disclosure. More of the Staff's specific comments are summarized below.

Manner of Presentation

- Companies should adopt a method of presentation tailored to their particular circumstances.

¹ The SEC's review is ongoing, correspondence containing the Staff's comments and associated company responses will be posted on the SEC website, www.sec.gov, not less than 45 days after the review process is completed.

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- Companies should consider emphasizing certain items of disclosure, such as those related to how and why compensation levels were established, and de-emphasizing others such as compensation program mechanics.

Format

- The CD&A should be a narrative overview at the beginning of the compensation disclosure used to provide a context for the numbers in the tables that follow it. Companies should always position the requisite tables behind the CD&A.
- Alternative methods of presentation, such as tables, charts and graphs, should be included to the extent they aid the reader's understanding; however, companies should ensure these additional materials do not overshadow the required tables.
- Companies may want to include a table presenting total amounts payable to named executives upon termination or change in control.
- Companies may be required to state that an alternative table is not a substitute for the information required by the revised rules if there is potential for confusion.
- Companies that presented alternative summary compensation tables should explain the differences between compensation amounts presented in those tables and compensation amounts presented in the required tables.

Clarity

- Companies should increase the font size in their tables and related footnote presentations to enhance readability.
- Companies should avoid using boilerplate discussions of individual performance or descriptions from compensation plans or employment agreements, instead focusing on more specific analysis of how the compensation committee considered and used individual performance to determine executive compensation.

Compensation Discussion & Analysis

- Principles-based disclosure requires companies to analyze and discuss material factors underlying their compensation policies and decisions.
- Companies should assess their own facts and circumstances to determine what elements of their compensation policies and decisions are material and warrant disclosure.
- Companies should focus their CD&A presentations on the substance of their compensation decisions, disclose how they analyzed information and why their analyses resulted in the compensation paid.

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- Companies should place in context how and why the determinations they made with regard to one compensation element may or may not have influenced decisions they made with respect to other compensation elements they contemplated or awarded.
- Companies that disclose the analysis of “tally sheet” information should explain what “tally sheet” information is and discuss how it impacted the committee’s decision on compensation awards.

Differences in Compensation Policies & Decisions

- The CD&A should be sufficiently precise to identify material differences in compensation policies and decisions for individual named executive officers.

Performance Targets

The Staff issued more comments regarding performance targets than any other area of disclosure. Most companies reviewed disclosed that their compensation committees considered individual performance in making executive compensation decisions, but few companies disclosed how they analyzed individual performance or whether they focused on specific individual performance goals as part of that analysis. The Staff noted that it often found it difficult to understand how companies used these performance targets or considered qualitative individual performance to set compensation policies and make compensation decisions.

- Companies that indicate performance targets were material to their policies and decision-making process and have omitted the specific targets should disclose the specific targets or show why disclosure would cause competitive harm.
- Companies that did not disclose specific performance targets should include more specific disclosure as to whether the company or the named executive officer achieved or failed to achieve targets in prior years.
- Companies that presented non-GAAP financial figures as performance targets and did not disclose how they calculated those figures, should explain how the measure was calculated and how it influenced compensation decisions.
- Companies may be required to present the context to the disclosure provided by discussing post-termination compensation arrangements, ongoing compensation arrangements and policies the company will apply in future.
- Companies may be required to disclose whether the company or a named executive officer achieved or failed to achieve targets in prior years depending on the particular facts and circumstances surrounding the decision, for example, where the company has a multiple year compensation plan or where target levels vary considerably between years.

Benchmarks

- Companies should provide a more detailed explanation of how they used comparative compensation information and how that comparison affected compensation decisions. If

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companies use comparative compensation information, but retain discretion on how to use it, they must provide appropriate disclosure.

- If companies benchmark compensation to their peers, they should identify the companies to which they compared themselves as well as the compensation components used in the comparison. Where companies indicate they benchmarked compensation to a vague or broad range of data regarding those companies, they should explain more specifically where their compensation fell within that range.

Change-in-control and Termination Arrangements

- Companies should disclose why they have structured the material terms and payment provisions in change-in-control and termination arrangements in a particular way.
- Companies should discuss how potential payments and benefits under these arrangements may have influenced their decisions regarding the other compensation elements.

Related Person Transaction Disclosure

- Companies should provide a statement that their policies and procedures for the review, approval or ratification of related person transactions are in writing and, if not, explain how they evidence their policies and procedures.

Corporate Governance

- Companies should provide a complete picture of which individuals and which procedures they relied upon to consider and determine executive and director compensation.
- Companies should thoroughly describe the role executive officers played in the decision-making process.
- Companies that have engaged compensation consultants should thoroughly describe the role the consultant played in the decision-making, as well as the nature and scope of his assignment and the material instructions the company provided to him.

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For further information about Babirak, Vangellow & Carr, P.C., and its lawyers, you may visit our web site at www.bvcpc.com. If you have any question regarding any topic covered in this Corporate Advisor or regarding any corporate finance or related matter, please feel free to contact the following:

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