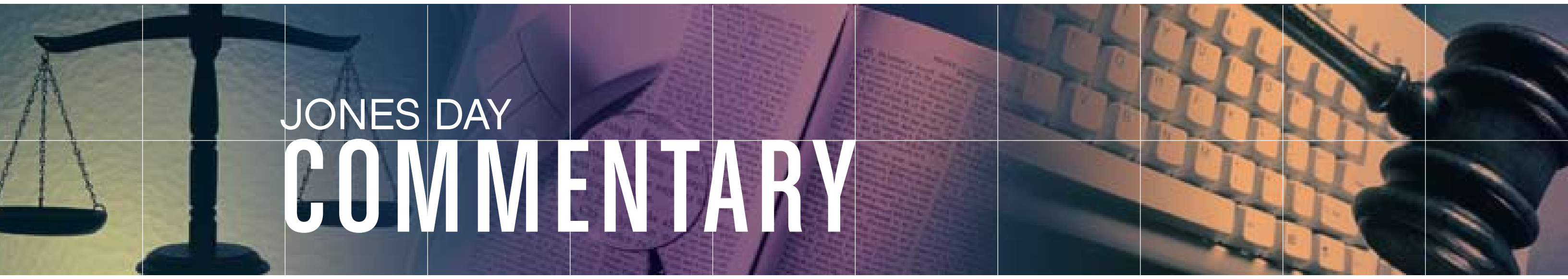
OCTOBER 2007



SEC STAFF OBSERVATIONS ON EXECUTIVE COMPENSATION DISCLOSURE

On October 9, 2007, the SEC Staff released its long-awaited report presenting its observations from the Staff's ongoing review of disclosures under the SEC's enhanced executive compensation rules.[1] On the same day the report was issued, John W. White, director of the Division of Corporation Finance, spoke at the 2nd Annual Proxy Disclosure Conference in San Francisco, providing further observations.[2] This *Commentary* analyzes the impact of the report and highlights important issues for consideration during the upcoming 2008 proxy season.

BACKGROUND

In 2007, the Staff undertook a review of the executive compensation disclosure of 350 public companies to evaluate compliance with the new executive compensation disclosure rules and to provide guidance on how these companies should improve disclosure in future filings. The Staff has indicated that its reviews are ongoing and that additional comment letters can be expected later this year.

1. *Staff Observations in the Review of Executive Compensation Disclosure*, Division of Corporation Finance, U.S. Securities and Exchange Commission, *available at* http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm.
2. "Where's the Analysis?" Speech by John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, at the 2nd Annual Proxy Disclosure Conference, San Francisco, California, October 9, 2007, *available at* http://www.sec.gov/news/speech/2007/spch100907jww.htm.

EMERGING THEMES AND OBSERVATIONS

The SEC's most significant observations include the following:

- Companies should provide more meaningful analysis regarding their specific executive compensation decisions. Meaningful analysis includes more focused disclosure of both:

  - How and why a company's compensation philosophies and decision-making processes resulted in the amounts the company presented in its tabular and narrative compensation disclosures; and

  - How the amounts awarded under each compensation element, and how the total compensation derived from all these elements, affected the decisions the company made regarding amounts awarded under other compensation elements.

- Companies should use plain English principles (careful and succinct drafting and various tabular and other nonnarrative methods of presentation) to provide more direct, specific, clear, and understandable executive compensation disclosure.[3] Material information should be emphasized, and less-important information should be de-emphasized.

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

- Disclosure of both *prior*- and *current*-year performance targets may be required, if material, based on all relevant facts and circumstances.

IMPACT OF THE SEC'S OBSERVATIONS

The Staff's observations made in the report do not present any radically new views, but rather continue the trend of prior Staff views. Director White has indicated that the initial disclosure made by companies in response to the revised executive compensation rules generally appears to have been made in a good-faith effort to provide clear and understandable disclosure, but that there is room for improvement. For future filings, the SEC will expect companies to have considered the additional guidance that has been provided and the comment letters that have become public and to have modified their disclosure accordingly.

3. *Plain English Disclosure*, Securities Act Release No. 33-7497 (January 28, 1998), *available at* http://www.sec.gov/rules/final/33-7497.txt. The SEC's *Plain English Handbook* is *available at* http://www.sec.gov/pdf/handbook.pdf.

In light of these expectations, 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, management should focus the committees on the thrust of the SEC's guidance—especially the themes of meaningful analysis and manner of presentation. Compensation committees should be focused on how and why they are making their decisions as those decisions are being made and should consider the impact of that decision making on the disclosure that will need to be included in the proxy statement. In fact, management may consider providing a summary of the Staff's observations to the compensation committee so that they may be aware of the disclosure obligations related to their executive compensation decisions.

The Staff has suggested that it may provide additional guidance as the 2008 proxy season approaches. In addition, companies should expect the Staff to scrutinize more intensely their 2008 executive compensation disclosure to confirm that the concerns raised in the recent report and other Staff guidance have been addressed. While this is likely to result in additional comments and guidance for future filings, to the extent the Staff views disclosure as being significantly deficient or not responsive to the guidance that has been provided, companies may be subject to additional burdens, including delays in the capital-raising process or comments to previously filed documents.

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