CLEARY GOTTLIEB

NEW YORK WASHINGTON PARIS BRUSSELS LONDON MOSCOW FRANKFURT COLOGNE ROME MILAN HONG KONG BEIJING

Common Questions: Navigating the SEC's New Compensation Rules

New York
January 19, 2007

Not surprisingly, the SEC's new compensation rules have raised a number of questions.[1] Members of the SEC staff have spoken at several programs, and we understand that the staff may issue additional written guidance, but the timing is uncertain. With companies now focused on preparing the 2007 proxy statement, we thought it would be useful to share a compilation of common questions we have addressed. Some of these matters involve interpretations of the new rules; others involve practice questions. We also have further materials that may be useful in considering your company's practices. These include policies for equity-based grants, recoupment of incentive compensation, limitations on severance, related person transactions and consultant independence, as well as updated director and officer questionnaires. Please call any of your regular contacts at the firm or any of our partners and counsel listed under Corporate Governance or Employee Benefits in the "Our Practice" section of our website if you have questions.

TABLE OF CONTENTS

Compensation Discussion and Analysis 2
Tables and Narratives 8
- Equity Compensation 8
- Non-Qualified Deferred Compensation 11
- Bonus and Incentive Plans 13
- Perquisites 14
- Severance and Change in Control Benefits 15
- Miscellaneous 19

Equity Grant Practices 23
Director Compensation 24
Officer Certification of Compensation Disclosures 26
Related Person Transactions 28

[1] *See* SEC Rel. No. 33-8732A; 34-54302A; IC-27444A (Aug. 29, 2006) (the "Adopting Release"), available at http://www.sec.gov/rules/final/2006/33-8732a.pdf; SEC Rel. No. 33-8765; 34-55009 (Dec. 22, 2006) (the "December Release"), available at http://sec.gov/rules/final/2006/33-8765.pdf. The new rules were proposed in SEC Rel. No. 33-8655; 34-53185; IC-27218 (Jan. 17, 2006), available at http://sec.gov/rules/proposed/33-8655.pdf.

© Cleary Gottlieb Steen & Hamilton LLP, 2007. All rights reserved.

This memorandum was prepared as a service to clients and friends of Cleary Gottlieb to report on developments that may be of interest to them. The information is general and should not be considered as legal advice.

COMPENSATION DISCUSSION AND ANALYSIS

Q-1. Who should be involved in writing and reviewing initial drafts of CD&A?

A-1. While early drafts of CD&A appear generally to be written by a combination of human resources professionals, compensation consultants and benefits and disclosure lawyers (internal and/or external, depending on the infrastructure of the company), we believe that other company personnel should be involved in the process prior to finalizing the CD&A. These include representatives from:

- the benefits accounting staff to confirm the accuracy of data;
- the controller and/or financial staff to assist in developing the business context for compensation decisions and in confirming data and the effectiveness of related controls to assure accurate reporting;
- the investor relations staff to anticipate likely questions from investors, the press and other constituencies – not only about the compensation figures, but about other practices of the company that may attract interest, such as the composition of the comparator group, the metrics used in compensation decisions, if they are based on financial measures other than those the company uses for other disclosure purposes, and the use and independence of compensation consultants;
- the internal communications staff to anticipate questions or concerns that employees may have as a result of the disclosures; and
- the external accountants for the company, insofar as matters of financial reporting and controls are also implicated by the new rules.

In addition, while the CD&A is company disclosure, it must reflect accurately the compensation philosophy and decisions of the compensation committee. It is therefore particularly important to obtain the input of compensation committee members at an early stage. Further, especially in light of the changes to disclosure of stock-based compensation in the Summary Compensation Table (promulgated by the SEC in the December Release) to require it to track more closely financial statement reporting, audit committees have a role, though a less significant one, in ensuring that disclosure derived from financial statements properly reflects the financial statement disclosures.

Finally, because of the continued applicability of the officer certification requirements of the Sarbanes-Oxley Act to executive compensation disclosure, including the CD&A under the new rules, CD&A should be reviewed on a timely basis by the CEO and CFO, using whatever procedures a company has in place for such review and related processes generally. *See also* Q&As 48 and 49 below.

Q-2. What steps are companies taking to prepare for inquiries about their compensation disclosures?

A-2. Steps that companies have taken vary based on their particular circumstances, but we believe that the following are relatively common steps, and we recommend all of them:

- Companies are advancing preparation of the new disclosures not only to provide for sufficient time for review by the compensation committee and CEO and CFO, but also to make sure that any future refinements of the company's compensation program or decisions – which occur for most companies in the first quarter of the year – are made with an understanding of how the decisions are likely to be reported in the 2008 proxy statement. (Actions taken in 2007 that relate to compensation programs or decisions in 2006 are subject to disclosure in the CD&A in the 2007 proxy statement even if any resulting compensation is itself disclosed in a proxy statement for a later year.) Circulating the draft in advance also has the advantage of ensuring that the appropriate internal constituencies have the CD&A in mind as the annual earnings release and related scripts and "Q&A" for the earnings call and other shareholder communications are being drafted, particularly if the company uses the release as a means to provide 2007 guidance or other business outlook information, including metrics that may be relevant to compensation decisions.

- Companies are including investor relations personnel in the drafting and review process for CD&A to help ensure that the "hard questions" are appropriately vetted or, as appropriate, explicitly addressed in the disclosure.

Q-3. Should the CD&A address all 15 factors listed in Item 402(b)(2) of Regulation S-K, even if some of them have no material bearing on the company's compensation program or decisions?

A-3. We believe that it is reasonable not to mention those factors that are not material to the company's compensation program or decisions. The rules state that these 15 items are examples of information that may be included depending on all the facts and circumstances.

Q-4. Are many companies using a "Q&A" format for the CD&A?

A-4. Not many companies seem to be using a "Q&A" format, although that approach would be acceptable.

Our experience suggests that most companies are using narrative disclosure that tries to give business context to individual compensation decisions. In preparing CD&A – and particularly to develop this contextual information – companies are taking into account their other public statements, all of which should work together with the CD&A to present an integrated, coherent picture of the company's performance and strategy and how they relate to compensation philosophy and decisions. These statements include the disclosures about the strategic direction of the company, the metrics that are disclosed in Management's Discussion and Analysis, statements about the business outlook of the company, analyst presentations and the Chairman's letter to shareholders.

Q-5. Are companies required to disclose target performance levels under incentive plans in the CD&A?

A-5. We believe that the proper reading of the rules is that where target levels are material to an understanding of a company's compensation program or decisions, they should be disclosed, unless the information is confidential and its disclosure may have an adverse competitive impact. See new Instruction 4 to Item 402(b) of Regulation S-K. There is no requirement to disclose targets generally.

In considering "materiality," we note that Item 402(b)(1) states that the CD&A "shall describe . . . . how the registrant determines the amount (and, where applicable, the formula) for each element to pay." In addition, the list in Item 402(b)(2) of information that may be material includes clauses (vi) and (vii) of that Item, which refer to how specific forms of compensation are structured and implemented to reflect the company's performance and the executive officer's individual contribution to company performance, respectively, and Instruction 5 to Item 402(b) discusses disclosure of target levels that are non-GAAP financial measures, indicating that the rules contemplate disclosure of targets where material to an understanding of compensation.

Where the amount earned under an incentive plan is formulaic, the target levels for performance elements in the formula may or may not be material to an understanding of the compensation. Where a company concludes that the target level is not material, a description of the formula, together with the disclosure of threshold, target and maximum payout levels in the Grants of Plan-Based Awards Table and disclosure of

material aspects of the application of the subjective metrics, may be appropriate to convey the material information about the executive's compensation. Different or additional disclosure may also be appropriate. In all events, judgments as to materiality and as to what information should be disclosed must be made based on all the individual facts and circumstances.

In the case of any formulaic compensation plan, whether or not target levels are disclosed, consideration should be given to noting aspects of the formula that may be material. For example, it may be material that a bonus formula is particularly "leveraged" or steep, on the one hand, or flat, on the other hand. Alternatively, it may be material that the range between threshold and maximum performance is particularly narrow or wide. In each case, an explanation of why the formula was designed in that way may be appropriate.

In considering matters of confidentiality and potential for competitive harm, we believe that metrics as to which the company provides guidance would not be entitled to confidential treatment. Where the metrics are not otherwise disclosed, whether disclosure would cause competitive harm is also a question that must be answered based on all of the individual facts and circumstances. The more specific and identifiable the potential harm, the more likely that the company will be able to demonstrate the need for confidential treatment. The need to preserve the confidentiality of a metric that has obvious strategic import (*e.g.,* one tied to planned divestitures at specific prices) may be more readily justifiable than metrics that reflect more general elements of a company's plan or budget about which the company regularly comments prospectively even if it refrains from providing "guidance."

Moreover, companies that do not disclose targets that are material are required to provide an indication of how the targets relate to expected performance by new Instruction 4 to Item 402(b), which provides that where targets are not disclosed based on a competitive harm argument, the company must discuss how difficult it will be for the executive of the company to achieve the undisclosed targets. In that situation, if the approach to setting targets has been historically consistent, it may be appropriate in response to this requirement to state that fact and to disclose the historic levels of achievement compared to the historic targets.

Q-6. Is a company required to identify the individual companies that are part of the group to which it compares itself for purposes of setting pay levels for named executive officers ("NEOs")? If not, are companies generally doing so?

A-6. Companies are required to identify the companies in their comparator group if the information is "material." As with all materiality judgments regarding proxy statement disclosure, in considering materiality for these purposes, companies should use the customary standards of materiality formulated by the courts and the SEC.[2]

There has been recent press commentary critical of companies that compare themselves for pay purposes to larger companies, which typically would have the effect of suggesting higher levels of pay. While there may be cases for which there are arguments that identifying the individual companies in the comparator group is not material, depending on the other factors disclosed that influence the choice of companies, most companies appear to be identifying the specific composition of their comparator groups, and we believe that this is best practice.

Q-7. Is a company required to state whether a consultant providing advice on NEO pay to the company's compensation committee is "independent" or to describe other services the consultant provided to the company (including fees paid)? Even if the disclosure is not required, are companies generally providing such disclosure?

A-7. There is no specific requirement to disclose these matters. Item 407(e) of Regulation S-K requires disclosure of the role of compensation consultants in compensation decisions, including the identity of the consultants, the nature and scope of their assignments and whether they are engaged directly by the compensation committee, but does not address other services that may be provided to the company by the consultants or their affiliates. Therefore, whether a company discloses this information will depend on its materiality to an investor's understanding of the company's compensation program and practices. That said, there has been increasing commentary about the "independence" of compensation consultants, as well as initiatives by activists to promote this type of disclosure. For example, a coalition of pension fund investors representing about $849.5 billion in assets recently sent letters to the compensation

[2] *See, e.g.*, *Basic v. Levinson*, 485 U.S. 224 (1988) (material if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available"); *Azrielli v. Cohen Law Offices*, 21 F.3d 512 (2d Cir. 1994) (material if "there is a substantial likelihood that a reasonable person would consider it important in deciding whether to buy or sell shares"); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*en banc*), *cert. denied sub nom Coates v. SEC*, 394 U.S. 976 (1969) (material if "reasonably certain to have a substantial effect on the market price of a security"). *See also* Staff Accounting Bulletin No. 99 – Materiality (Aug.12, 1999).

committee chairs of the 25 largest U.S. companies by market capitalization seeking this disclosure, among other matters.[3]

Given this intense investor focus, many companies appear to be providing information about their consultants' services and fees even if they might reasonably conclude that disclosure is not necessary under the rules. Some are also including statements to the effect that, given the scope of the services provided and the fees earned, the ability of the consultant to provide an independent perspective to the compensation committee is not impaired; whether it is appropriate for a company to include that statement of course depends on all the facts and circumstances.

Where the compensation consultant has not actively participated in drafting the CD&A from the early stages, companies appear to be providing the consultant with an advance draft to confirm that the consultant agrees with the manner in which its services are characterized. SEC rules do not require, however, that companies obtain and file with the SEC a consent of the consultant to be named in the CD&A since the consultant is not an "expert" for purposes of those rules.

Some companies are also considering refinements of their practices with respect to the retention of compensation consultants, often in ways that are modeled on the approach used in the case of the retention of independent auditors. More companies are requiring that consultancy arrangements with any consultant engaged by the compensation committee be evidenced by a written agreement between the consulting firm and the committee. Companies are also implementing guidelines to help the committee and management monitor the level, nature and cost of consultancy services to each of the committee and the company so as to avoid inadvertent engagements that could affect a consultant's independence or investor perception of independence.

Q-8. Are the new rules driving compensation committees to have their own compensation consultant in addition to any consultant engaged by management?

A-8. We believe that some companies have determined that it is appropriate to have a separate consultant for purposes of advising the compensation committee. Other companies continue to have company-engaged consultants produce materials for review

[3] The letter, which may be found at http://www.state.ct.us/ott/pressreleases/press2006/pr102306letter.pdf, stated that "multiple business relationships [of a compensation consultant] within a company may compromise the independence of a consultant's recommendation to the compensation committee and may jeopardize shareholder confidence. . . . The concerns that institutional investors have regarding compensation consultant independence are analogous to those raised in recent years regarding auditor independence."

by the compensation committee without the committee's separate retention of a consultant. While we do not believe that having a separate compensation committee consultant is necessary, in light of the intense investor focus on executive compensation it is prudent for the committee to retain its own consultant (as well as its own counsel) when major compensation decisions are being taken. The most common example is the negotiation of the CEO's employment contract or other material employment arrangements for the CEO.

Q-9. If a company wishes to implement independence guidelines for compensation consultants, is it necessary to prohibit the consultants for the compensation committee (or their affiliates) from undertaking any other services for the company or management?

A-9. We do not believe that such a guideline is necessary, although we note that some companies have taken that approach. Many companies are analogizing to the regulations applicable for purposes of auditor independence. In doing so, they are permitting certain other engagements with the company to occur only so long as the nature of the services provided and the relative amount of fees attributable to non-committee work are not such as to be incompatible with the consultant's ability to provide objective advice to the compensation committee. A common example is the general compensation survey that many consultants conduct and sell for modest fees. Some companies are also requiring that the compensation committee directly approve (or pre-approve) any other engagement involving the company and the compensation committee consultant, again by analogy to the rules governing a company's relationship with its auditor. Still others – a minority in our experience – are prohibiting the compensation committee consultant from providing any services whatsoever to management. Finally, while we expect that consultants for compensation committees will continue to have direct interactions with management, we also expect that companies will take greater care to ensure that those interactions do not result in inappropriate "filtering" of information that should properly be presented to the compensation committee.

TABLES AND NARRATIVES

Equity Compensation

Q-10. The disclosure in the Summary Compensation Table as to stock-based compensation should follow the financial accounting treatment under Statement of Financial Accounting Standards ("SFAS") No. 123(R) (Share-Based Payment). Would

performance shares be valued at the target or maximum payout level for purposes of the Summary Compensation Table?

A-10. Because the new rules require companies to follow the financial accounting treatment, companies should consult with their internal and external accountants in reaching a conclusion in their particular circumstances. However, we note that Paragraph 44 of SFAS No. 123(R) states that "accruals of compensation cost for an award with a performance condition shall be based on the probable outcome of that performance condition." According to footnote 25 of SFAS No. 123(R), the term "probable" is defined under SFAS No. 5 (Accounting for Contingencies) as happening when "the future event or events are likely to occur."

Paragraph 44 further states that "compensation cost shall be accrued if it is probable that the performance condition will be achieved and shall not be accrued if it is not probable that the performance condition will be achieved. If an award has multiple performance conditions (for example, if the number of options or shares an employee earns varies depending on which, if any, of two or more performance conditions is satisfied), compensation cost shall be accrued if it is probable that a performance condition will be satisfied. In making that assessment, it may be necessary to take into account the interrelationship of those performance conditions."

Under most plan designs, if a plan defines a "target," that target will usually, but not always, be viewed as the probable outcome. Some plans do not have targets, and some targets involve sufficient "stretch" that the accountants may determine that the target outcome is not probable of occurrence.

Q-11. Should outstanding restricted stock units, and other equity-based promises to pay amounts in the future, be reported as non-qualified deferred compensation prior to the time such awards vest? For example, a company has a deferred stock bonus plan that works as follows. The number of shares to be paid is determined by a formula keyed to a one-year performance period. The shares "earned," based on the formula, are paid to the employee three years after the end of the performance period, but only if the employee is still employed at the payment date.

A-11. No. The value of the shares should be reported in the Summary Compensation Table over the period for which compensation expense is recognized with respect to such awards in an amount each year derived from the amount expensed in the financial statements in accordance with SFAS No. 123(R). Such awards should be reported in the Outstanding Equity Awards at Fiscal Year-End Table until vesting and in the

Options Exercised and Stock Vested Table in the year of vesting. If payouts are deferred after vesting, then amounts payable generally should be reported as non-qualified deferred compensation and not as outstanding equity awards.

Q-12. Pursuant to the December Release, compensation of the type referred to in Q-11 is generally required to be reported in the Summary Compensation Table in amounts calculated for financial statement reporting purposes pursuant to SFAS No. 123(R). As a result, the amount of stock-based compensation disclosed in that Table can be very materially different for two NEOs who receive identical stock-based compensation awards (which vest upon the earlier of completion of a period of service or retirement from the company) and are identically situated except that one of them has reached retirement age and the other has not. As to the first NEO, the full grant date fair value of the stock-based compensation may be immediately expensed and reported as compensation in the year of grant in the Summary Compensation Table, whereas as to the second NEO only the portion of the grant date fair value that represents the portion as to which the service period (generally the vesting period) runs during the year in question may be required to be expensed and reported in that Table. In both cases, the full grant date fair value on a grant-by-grant basis will appear in the subsequent Grants of Plan-Based Awards Table. Are companies required to provide disclosure that identifies and discusses the discrepancies in amounts of compensation of two such NEOs appearing in the Summary Compensation Table?

A-12. We recommend that the discrepancy in treatment of two NEOs as a result of this anomaly in the interim final rules be disclosed where the amount of the discrepancy is material and such disclosure is necessary to provide an understanding of the compensation of the NEOs in question. This will depend on the facts and circumstances. An explanation of the discrepancy can be made by reference to the amounts in the Summary Compensation Table and the full grant date fair value of grants disclosed in the Grants of Plan-Based Awards Table. The appropriate places to provide such disclosure would be either in footnote disclosure to the Summary Compensation Table or in the CD&A.

Q-13. Also pursuant to the December Release, the amount of stock-based compensation disclosed in the Summary Compensation Table is generally the amount expensed by the company for the year in question. Therefore, depending on the time within a year when stock-based compensation is granted, the amount expensed can be materially different. For example, for a company with a December 31 fiscal year, options granted to an NEO in respect of 2006 on February 1, 2006 will generally be expensed in an amount reflecting a service period of 11 months (and the 11-month amount disclosed in the

2006 Summary Compensation Table), while options granted in respect of 2006 on December 1, 2006 will generally be expensed in an amount reflecting a service period of one month (and the one-month amount disclosed in that Table). Indeed, for such a company, options granted in respect of 2006 on February 1, 2007 will generally not be expensed at all in 2006 (and no compensation in respect of such options will be reflected in the 2006 Summary Compensation Table). Should a company make disclosure of the impact of the timing of the grant of stock-based compensation on the amounts of such compensation reflected in the Summary Compensation Table?

A-13. By reading the Grants of Plan-Based Awards Table and identifying the grant date of stock-based compensation awards, an investor will generally be able to extrapolate the period for which such compensation has been expensed (and thus the service period for which disclosure has been provided in the Summary Compensation Table). Nonetheless, we recommend that, especially where grant dates fall late in a fiscal year, and therefore the amount that would be disclosed for a full 12-month service period is materially greater than the amount actually disclosed in the Summary Compensation Table, companies should disclose in a footnote to the Summary Compensation Table the period of time within the year that represents the service period for which disclosure is provided and what the amount would be for a full 12-month service period. As to grants in a fiscal year in respect of the preceding fiscal year, we believe that the rules require that decisions taken following the end of a fiscal year in respect of the prior fiscal year that are material to an understanding of the compensation of NEOs for that prior fiscal year be disclosed in the CD&A. We recommend that such disclosure include the fact that no amount in respect of such stock-based compensation is reflected in the Summary Compensation Table and the amount that would be reflected for a 12-month service period.

Non-Qualified Deferred Compensation

Q-14. For purposes of determining whether earnings are "above-market," should a company compare the rate credited under the plan to market rates at the time that the relevant earnings rate is set or to the market rates in effect during the fiscal year for which disclosure is being made? What if the company has discretion to adjust the rate after the rate is initially determined?

A-14. The plan's rate should be compared to market rates at the time that the plan's rate is set. For example, if the plan uses an 8% interest rate for deferrals made in a particular fiscal year, and that rate is no higher than 120% of the applicable federal rate ("AFR") at the time that the rate was set, then it is not an above-market rate – even if 8% would be an

above-market rate in the later fiscal year for which proxy reporting is being made. Although not explicitly required under the new rules, the company may wish to provide a footnote explanation in the proxy statement about how rates were set and how the plan rates compared to market rates at the time that the plan rates were set. Generally, we believe that this approach is reasonable even if the company has discretion to change crediting rates and chooses not to do so despite changes in market rates.

Q-15. If a plan compounds interest daily, how should the company determine if the rate is above-market?

A-15. AFRs are only published in annual, semi-annual, quarterly and monthly terms. The rules state that a company must compare the 120% AFR rate with compounding that corresponds most closely to the rate under the plan. Reading the language of the rules literally, we believe that the company could simply compare its rate compounded daily to the 120% AFR compounded monthly (as the rate that most closely corresponds to the plan rate). However, as a rate compounded daily would be lower than the monthly compounded rate of equal value, we also believe that it would be reasonable, for purposes of comparison, either to adjust the plan rate to a monthly rate of equal value or to adjust the 120% AFR monthly rate to a daily rate of equal value before comparing the two rates.

Q-16. If a plan uses the same monthly compounding crediting rate for each full fiscal year, which monthly AFR should be used for the comparison?

A-16. The company should use the monthly AFR for the month in which the plan's crediting rate is set or reset. For example, if the rate under the plan is set or reset effective January 2007, then the company should use the 120% AFR rate published for January 2007 for purposes of comparison.

Q-17. Are earnings on non-qualified deferred compensation required to be treated as "above-market" if amounts are invested (or notionally invested) in an investment fund that yields high returns?

A-17. Under the old rules, above-market earnings disclosure was not required if the amounts were invested (or notionally invested) in an option available in the company's qualified plan. There is no new SEC guidance on this subject as part of the new rules, and we believe that it is reasonable to assume that the approach under the prior rule continues to apply. If the investment in the non-qualified plan is not available in the company's qualified plan, the answer is unclear. Although the judgment in any case will likely

depend on the particular facts of that case, if the investment fund is widely available to the public, then it will probably be reasonable to conclude that the earnings are not required to be treated as "above-market." Where there is a high return on an investment opportunity that is neither available under the company's qualified plans nor widely available to the public, then, in the absence of other particular factors, a company should generally conclude that the earnings are "above-market."

Q-18. The Instruction to Item 402(i)(2) of Regulation S-K requires footnote disclosure of the extent to which amounts included in the "Aggregate Balance at Last Fiscal Year-End" column of the Nonqualified Deferred Compensation Table were previously reported as compensation to the NEO in the Summary Compensation Table for prior years. Must the company identify amounts reported in the Summary Compensation Table in years prior to the adoption of the new rules?

A-18. It has been reported that the SEC staff is taking the view that this requirement will only apply prospectively and it is not necessary to identify amounts reported in the Summary Compensation Table prior to 2006. However, as the point of the footnote is to ensure that shareholders do not "double-count" previously disclosed compensation, companies may wish to consider undertaking the identification exercise with respect to prior years.

Bonus and Incentive Plans

Q-19. Are cash payments that consist of "qualified performance-based compensation" under Section 162(m) of the U.S. Internal Revenue Code (the "Code") necessarily disclosed as "non-equity incentive compensation," rather than bonus in the Summary Compensation Table?

A-19. No. It is appropriate to consider whether amounts payable under the arrangement are generally subject to the exercise of significant "negative discretion," in which case disclosure in the "Bonus" column may be more appropriate. Regardless of the column in which it is reported, footnote disclosure should provide an explanation of the material terms of the compensation.

Q-20. In the "Bonus" and "Non-Equity Incentive Plan Compensation" columns of the Summary Compensation Table, may a company report bonuses under different plans (*e.g.*, an annual cash incentive plan and a long-term cash incentive plan) separately within the column? If so, must the company provide a total?

A-20. We believe that it is reasonable to report bonuses under different plans separately within the column, and we recommend that the company provide a total. Instruction 2 to Item 402(c) of Regulation S-K states that a single numerical value must be provided for each grid in the Summary Compensation Table. We believe that this requirement would be satisfied if the different plan amounts are identified separately and a total is provided.

Q-21. A cash incentive plan has a three-year performance period. Prior to the end of the entire period, it is not possible to determine the total amount of bonus that will be earned. However, performance during years one and two may determine minimum payout amounts. Are these minimums required to be disclosed as earned in the Summary Compensation Table for years one and two?

A-21. Generally no. However, if the plan design includes "banking" the minimum earned amounts (*i.e.*, during each year of the performance period, the participant earns a certain portion of the potential bonus, which cannot thereafter be subject to forfeiture), then it may be appropriate to report the banked amounts in the Summary Compensation Table. We note that, in the case of an incentive plan award that is within the scope of SFAS No. 123(R) (generally, performance-based equity awards), the treatment is different and is now governed by the December Release, *i.e.*, the compensation cost is recognized, and consequently disclosed in the Summary Compensation Table, based upon the probability of achieving the performance condition as described in A-10 above.

Perquisites

Q-22. A company gives each NEO a cash allowance each year that may be applied towards the purchase of any personal benefits that the NEO chooses. Are the amounts reportable as perquisites or bonus? Is the full amount reported for an NEO who does not spend his full allowance?

A-22. We believe that it is reasonable to report the amounts as either perquisites or bonus and to report only the amount actually paid.

Q-23. A company has a relocation policy that is available, in principle, to all employees to whom the relocation benefits may lawfully be provided. As a practical matter, however, the company has principally relocated executive officers. May the company exclude consideration of the relocation benefits as a perquisite given their "general availability on a non-discriminatory basis to all employees" as provided in the Adopting Release?

A-23. The relocation benefits will not fall outside the definition of perquisite solely on the basis that they are in principle generally available. As noted in the Adopting Release, "merely providing a benefit consistent with its availability to employees in the same job category or at the same pay scale does not establish that it is generally available on a non-discriminatory basis to all employees." We also note that Item 601(b)(10)(iii)(C)(4) of Regulation S-K permits a company to omit disclosure about certain management contracts, plans or arrangements only if they "in operation" provide for the same method of allocation of benefits between management and non-management participants and that Instruction 3 to the amended Item 5.02 of Form 8-K states that companies need not provide disclosure with respect to broad-based plans to the extent that they do not discriminate in "scope, terms, or operation" in favor of executive officers.

Q-24. A company provides "Benefit X" to an NEO. Is Benefit X subject to disclosure as a perquisite?

A-24. The identification of perquisites subject to disclosure under the new rules is a highly fact-intensive question. The Adopting Release states that the concept of a benefit that is "integrally and directly related" to the performance of an executive's duties and therefore not a perquisite is a narrow one, and potential perquisites should be carefully considered in light of the specific facts and circumstances to determine whether they fit that description. Companies considering refinements of their disclosure controls and procedures to improve their ability to monitor and capture information about benefits that may be perquisites should also be mindful that the classification in any given year of a benefit payable to a particular NEO may change, depending on all the facts and circumstances.

Severance and Change in Control Benefits

Q-25. For severance benefits that are paid over time to NEOs, when is disclosure required in the "All Other Compensation" column of the Summary Compensation Table?

A-25. The rules and guidance are not clear, and we believe that this is an area in which the SEC staff may provide additional guidance. Absent guidance to the contrary, we believe that it is reasonable to take the view that amounts are required to be included in that column only for the year in which they are actually paid. In our view, the timing of the disclosure should typically not be affected by the existence of non-competition, confidentiality, release of claims or other similar agreements that may be associated with the severance obligation.

Unlike Item 402(b)(2)(v)(A) of Regulation S-K prior to these amendments, for which the SEC staff took the view that the entire benefit had to be present valued, Item 402(c)(2)(ix)(D) of Regulation S-K as amended does not refer to amounts payable under post-employment benefits. Instruction 5 to Item 402(c)(2)(ix) of Regulation S-K provides that an accrued amount is an amount for which payment "has become due" and Footnote 217 of the Adopting Release explains that an amount for which payment has become due includes "a severance payment ***currently owed*** by the company to an executive officer," as distinct from an amount "payable in the future."

In addition, in all events, the full amount of the severance benefit payable to NEOs is required to be disclosed in the narrative discussion of severance and change in control benefits. The timing of inclusion of severance benefits in the Summary Compensation Table may, however, determine whether an executive officer whose employment has been terminated will be required to be named.

Q-26. A portion of the severance benefit payable to an NEO relates to bonus compensation for the year in which the NEO's employment ends. The bonus is objectively determined and pro rated for employees whose employment is terminated without cause during the year. Should the bonus component of the severance be reported in the "Non-Equity Incentive Plan Compensation" column or in the "All Other Compensation" column in the Summary Compensation Table? What if the pro rata bonus gets paid for employees who quit, die or become disabled during the year?

A-26. The bonus should generally be reported in the "All Other Compensation" column since it became payable pursuant a plan or arrangement in connection with the executive officer's termination of employment. However, if the pro rata bonus is also payable upon voluntary termination, then we believe it would be reasonable to report it instead in the "Non-Equity Incentive Plan Compensation" column. Footnote disclosure should be considered where clarification would provide material information necessary to an understanding of the payout.

Q-27. Separation pay benefits for an NEO are delayed for six months in compliance with Section 409A of the Code. Upon expiration of the six-month period, the Company pays interest on all amounts that were delayed, including dividend equivalents, retirement account contributions, salary and bonus. If the payment of the separation payments are reported in the Summary Compensation Table (*i.e.,* if the NEO is terminated during the first six months of the reportable year), where do the interest and other amounts get reported in the Summary Compensation Table?

A-27. The entire payment should be treated in the same way as the rest of the severance package – that is, aggregated with other severance payments and included in the "All Other Compensation" column. We do not believe that a company must necessarily quantify and describe the interest portion separately, even if that component exceeds the $10,000 threshold that applies to items other than perquisites and personal benefits. It should be sufficient to include footnote disclosure quantifying and describing the severance payments as a whole for each relevant NEO. In that disclosure, the company should describe the components of the severance package and note that the NEO received these interest payments in respect of the six-month delay if that is material in light of the amounts involved.

Q-28. The new rules require narrative disclosure of change in control ("CIC") and severance benefits in the "Potential payments on termination of employment or change in control" section of the proxy statement (the "CIC/Severance section"). Must the presentation disclose the total amounts payable at or following termination of employment or a CIC, or just the incremental value resulting from the event?

A-28. In general, we believe that in the CIC/Severance section it is reasonable to focus on and disclose incremental value, rather than total value, but in a manner that (i) makes clear it is incremental to other disclosed amounts and (ii) permits calculation of the total amounts. For example, if an NEO has an account balance in a non-qualified deferred compensation plan, a SERP or a performance bonus that gets paid out in accordance with its terms following termination of employment and where the value of the benefit is not affected by the termination of employment, then we believe that the company may include narrative disclosure referring to the applicable presentation of the other amounts payable (*i.e.*, the Nonqualified Deferred Compensation Table, the Pension Benefits Table or the Grants of Plan-Based Awards Table, as applicable) and then disclose the incremental amount that would be payable in addition to those referenced amounts. The disclosure should provide all of the information necessary to calculate a total amount.

For options and other outstanding equity awards that vest upon termination of employment or CIC, we recommend that the company disclose the intrinsic value of the awards for which vesting is accelerated (*i.e.,* the excess of the fair market value of the stock over the amount (if any) the NEO would be required to pay for the stock, such as the exercise price of an option). We do not, however, recommend that companies seek to quantify the value of the accelerated vesting itself apart from the value of the awards for which vesting is accelerated. For example, we do not believe that disclosure of a value for accelerated vesting based on the regulations under the "golden parachute" excise tax rules (Section 280G of the Code) would be meaningful for most shareholders.

For severance benefits and other benefits for which incremental value is delivered as a result of the CIC or severance event, the amount of the incremental value must be aggregated and disclosed. In other words, if an amount payable after termination of employment is either (i) incremental to an amount set forth in a table or (ii) not integrally related to an amount set forth in a table, then the company must disclose the full amount in the CIC/Severance section.

Instruction 2 to Item 402(j) of Regulations S-K states that, for purposes of quantifying health care benefits, the company must use the assumptions used for financial reporting purposes under generally accepted accounting principles. This statement implies that benefits payable over time must be present valued and reported as a lump sum, particularly if there are generally accepted accounting principles that govern the valuation methodology to be used. If the incremental value is based on providing a benefit for life (*e.g.*, the use of the company aircraft for life) and lump sum valuations of the benefit are not required under GAAP, we believe that a company may disclose the annual value of the benefit and that it is payable for life, rather than calculating a present value of the benefit.

We believe that it is reasonable to take the approach set forth in this Answer in response to the call in the rules for disclosure of all "payment(s) to a named executive officer at, following, or in connection with any termination . . . or a change in control," because (i) Instruction 3 seems to contemplate this approach for pension and non-qualified deferred compensation, and it is not clear why other benefits should be treated differently; (ii) under our recommended approach, the information about non-incremental payments will be disclosed; and (iii) under our recommended approach, the total amount can be calculated. Although we believe that the focus should be on the incremental amount, we would recommend disclosure of the non-incremental amounts in the CIC/Severance section as well.

Q-29. A company issues two types of restricted stock unit ("RSU"). Type 1 is a fixed award of a specified number of shares that, once performance targets have been achieved, pays out based on the 20-day average trading price of the stock preceding the payment date. Type 2 is a "profit-based" award where the actual number of shares is not fixed at grant but is based on company performance during a performance period. After the end of the performance period, the number of shares becomes fixed but they still are not vested until a scheduled payment date in the future, subject to the employee's continued employment through the payment date. Both types of RSUs by their terms provide that on certain terminations of employment, the vesting conditions are waived (*i.e.*, the awards are no longer forfeitable), but the employee must wait for the regularly-

scheduled payment date to receive payment. How should these be reflected in the CIC/Severance section?

A-29. We believe that the company should explain how the awards work, how they are calculated and what the value of the RSUs would be if they paid out based on the stock price on the last day of fiscal year to which the proxy statement relates.

Miscellaneous

Q-30. The determination of NEOs is based on total compensation (other than pension accrual and above-market interest on nonqualified deferred compensation). For purposes of calculating total compensation under the new rules, the SEC stated in the December Release that "if the [NEO] fails to perform the requisite service and forfeits [an] award, the amount of compensation cost previously disclosed in the Summary Compensation Table [with respect to such award] will be deducted [in the Table] in the period during which the award is forfeited." The SEC also stated that "a negative number would result if the value of awards forfeited in a fiscal year by a named executive officer exceeds the value of other awards recognized in the Summary Compensation Table for that same [NEO]. Such a negative number will be disclosed in the relevant column and affect the calculation of 'total' for purposes of determining who is [an NEO]."

If the compensation cost of an award forfeited by an executive officer was not previously disclosed in the Summary Compensation Table because the award was made prior to 2006, should the company reduce the total compensation of such executive officer by the compensation cost that would have been reflected in the Summary Compensation Table for a prior year with respect to the forfeited award had the new rules applied at the time the award was made? Do the forfeitures only offset the compensation cost that is reflected in the Summary Compensation Table with respect to other awards, or do they offset other compensation amounts such as bonus or salary?

A-30. Absent other guidance, we believe the better view is that the executive officer's total compensation for 2006 should reflect a reduction for forfeited awards granted in prior years to the extent that amounts with respect to such awards would have been included in the Summary Compensation Table had the new rules applied at the time the award was made. It appears that such reductions would offset any compensation that would be required to be reported in the Summary Compensation Table.

Q-31. Instruction 3 to old Items 402(b)(2)(iii)(A) and (B) of Regulation S-K appears on its face to state that, if compensation may be paid in cash or stock at the election of the

NEO, the company may disclose the amounts paid in either the cash or stock columns of the Summary Compensation Table. The SEC staff previously interpreted the Instruction so as to distinguish between arrangements in which the stock is freely tradable or subject to restrictions, such as vesting, and to eliminate the apparent distinction between elective and non-elective arrangements. *See* Telephone Interpretation No. J-10 and SEC Interpretive Letter to the American Bar Association (Dec. 11, 1992). As a result, the Instruction seemed to mean that where compensation may be paid in either cash or restricted stock, whether electively or mandatorily, the company had a choice as to its disclosure approach. Where the compensation may be paid in either cash or freely tradable stock, whether electively or mandatorily, the company must disclose as if it were paid in cash.

The December Release addressed this Instruction and appears to say that the company will no longer have a choice – that is, it must provide disclosure in the Summary Compensation Table as if any amount subject to the Instruction were paid in cash. *See* the text at footnote 32 of the December Release*; but see* Section II.C.1.b and footnote 142 of the Adopting Release. However, the language of the amended Instruction is similar to that of the old Instruction in that it appears to distinguish between elective and non-elective arrangements, and it does not appear to distinguish between restricted stock and freely tradable stock. Should the new Instruction be interpreted in the same way that the old Instruction was interpreted by the SEC staff – that is, so that it applies to both elective and mandatory arrangements and so that it does not apply to arrangements that provide for payment of benefits in either cash or free stock?

A-31. In the absence of guidance, we recommend that the new language be interpreted as written and that the old interpretations be viewed as no longer applying.

Q-32. How should a company convert compensation denominated in other currencies into U.S. dollars under the new rules?

A-32. The new rules do not mandate a particular currency conversion rate or methodology, but the company must describe the rate and methodology used for converting the payment amount into dollars. *See* Instruction 2 to Item 402(c) of Regulation S-K. We believe that reasonable methods include using the currency conversion rate on the last day of the fiscal year (provided the rate did not fluctuate dramatically during the year), using the average rate over the course of the fiscal year and using the methodology used for financial reporting purposes.

Q-33. A company maintains a retiree health insurance program. Various features of the program differ depending on specified eligibility criteria, including for example grandfather rules based on age or years of service accrued as of a certain date in the past. The eligibility criteria do not discriminate by their terms or in operation in favor of highly-paid employees. However, not all of the benefits under the plan are available to all salaried employees, since significant groups of salaried employees do not meet some of the different eligibility criteria. One or more NEOs are entitled to certain of the benefits that are not available to all salaried employees. Is the plan described in the last sentence of amended Item 402(a)(6)(ii) of Regulation S-K ("registrants may omit information regarding group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms or operation, in favor of executive officers or directors of the registrant ***and*** that are available generally to all salaried employees")?

A-33. We believe that it would be reasonable for the company to take the view that the retiree medical benefits for named executive officers fall within the type of plan that may be omitted for the following reasons. First, we note that virtually all group life, health, hospitalization and medical reimbursement plans contain eligibility criteria of one type or another for different benefits that may be provided under the plan (*e.g.*, a minimum service requirement, an exclusion for pre-existing conditions or a requirement that covered participants take a medical exam), so that it would be rare for all of the benefits under a plan to be available to all salaried employees. In order to avoid an interpretation that makes the entire exclusion virtually irrelevant, we would interpret the words "available generally" not to preclude customary eligibility criteria (*e.g.*, grandfather rules) that do not by their terms or in operation discriminate in favor of highly-paid employees. Instead, we interpret the words to mean that the plan must cover all salaried employees, subject to such eligibility criteria. We note that this does not make either of the first or the second part of the sentence duplicative or unnecessary. The first part of the sentence states that all of the provisions must be non-discriminatory, and the second part states that the plan must extend coverage (which coverage may be subject to non-discriminatory eligibility criteria) to all salaried employees. Second, we view this interpretation as consistent with a principles-based approach to the new rules. That is, we do not view broad-based retiree medical programs to be the type of program that the SEC intended to cover. Of course, the SEC would likely take a different view in the event it concluded that a plan had been designed as a "scheme to evade," rather than a bona fide broad-based plan.

Q-34. A company maintains a broad-based program that provides certain CIC benefits generally to all salaried employees on a non-discriminatory basis. However, certain provisions of the plan apply differently to different salaried employees based on

grandfather rules. Is the plan described in Instruction 5 to amended Item 402(j) of Regulation S-K ("the registrant need not provide information with respect to contracts, agreements, plans or arrangements to the extent they do not discriminate in scope, terms or operation, in favor of executive officers of the registrant ***and*** that are available generally to all salaried employees")?

A-34. The language of Instruction 5 could be interpreted as set forth above in Q&A 33 above. However, from a principles-based perspective, we believe that it would be prudent to include information concerning the CIC benefits in response to Item 402(j) of Regulation S-K, since CIC benefits are among the areas of significant investor focus that in part motivated the revision of Item 402 of Regulation S-K.

Q-35. Does participation by an NEO in a broad-based employee stock purchase plan that qualifies under Section 423 of the Code and that provides for a discount of 15% give rise to reportable compensation?

A-35. We believe that it is reasonable to take the view that participation in this type of plan does not give rise to reportable compensation, because these plans are required to offer participation to substantially all employees on a non-discriminatory basis and because the SEC staff had informally taken the view under the old rules that disclosure was not required. We believe that footnote 221 of the Adopting Release does not require the contrary result for plans that are non-discriminatory.

Q-36. Instruction 2 to Item 402(h)(2) of Regulation S-K states that, for purposes of calculating the actuarial present value of an NEO's accumulated pension benefits, a company must use the same assumptions that it uses for financial reporting purposes, except for the retirement age assumption. Instead, the NEO's retirement age is to be based on the normal retirement age as defined in the plan, or, if not so defined, is to be based on the earliest time at which a participant may retire under the plan without any benefit reduction due to age. The benefit payable at the earliest retirement age can be more valuable than the benefit payable at normal retirement age. In that case, should the higher value be reported?

A-36. The SEC staff has taken the view that the higher value or both values should be reported. If the amount of the early retirement subsidy is material to an understanding of the plan (*i.e.*, if the amount at early retirement is materially higher than the amount at normal retirement), we believe that the amount of the subsidy or both normal retirement and early retirement amounts should be disclosed. For purposes of the amount disclosed in the Pension Benefits Table itself and the calculation of the pension accrual

amount disclosed in the Summary Compensation Table, we believe it is appropriate to provide the value at normal retirement age and include appropriate footnotes regarding the subsidy or value at early retirement.

Q-37. Is it reasonable to continue to rely on previously-issued SEC staff guidance, including telephone interpretations, with respect to requirements in the new rules that have not changed materially from the old rules to which the guidance related?

A-37. Generally yes, unless and until the SEC staff indicates otherwise.

EQUITY GRANT PRACTICES

Q-38. Are companies generally making disclosure about equity incentive grant practices? Are companies adopting equity incentive grant procedures? Can procedures adopted in 2007 be described in this year's CD&A? If a company adopts new procedures, must old procedures (or the lack thereof) be described?

A-38. Most companies are including disclosure in the CD&A about their equity grant practices. Most are also adopting equity grant procedures or refining existing procedures. We believe that procedures adopted in 2007 may (and in at least some cases should) be described in the CD&A included in the 2007 proxy statement. Although particular unique circumstances (*e.g.*, where the omission would make the disclosed information misleading) may dictate a contrary conclusion, we believe that companies that adopt new equity grant procedures should generally not be required to describe their old procedures (or the lack thereof). However, the CD&A should disclose when the procedures described were adopted.

Q-39. Are most companies conforming their option pricing to make the exercise price equal to the closing price on the grant date?

A-39. Practices are mixed, but most companies appear to be retaining their existing practices. In some cases, for example where the company grants options with an exercise price equal to the closing price on the day before the grant date, or on the average price on the grant date, existing practices may result in the need to include an extra column in the Grants of Plan-Based Awards Table to disclose the excess of the grant date's closing price over the exercise price. Many companies are voluntarily including that column to also disclose the difference between the exercise price and the grant date closing price when the grant date closing price is less than exercise price. This approach can highlight for shareholders that the company's decision not to use the grant date closing

price is "neutral" in intent and the effect depends on the direction in which the market moves.

Q-40. If the exercise price of directors' options is based on the closing price of the underlying stock on the day before the date of grant, is any excess of the closing price over the exercise price on the grant date required to be disclosed, as in the case of NEOs?

A-40. Generally no, unless for example the amount is so large that omission would make the disclosure misleading.

DIRECTOR COMPENSATION

Q-41. New Item 5.02(d)(5) of Form 8-K appears to require disclosure of material elements of director compensation when a new director is elected or appointed other than at a shareholders' meeting, including regular director fees that have previously been disclosed in the proxy statement. Can the "materiality" qualifier in Item 5.02(d)(5) be read to mean that the disclosure of regular director fees is not required?

A-41. Generally no. Disclosure may be made by reference to the prior disclosure, with the disclosure incorporated by reference into, or included in, the Form 8-K, as suggested in Q&A 42.

Q-42. In the circumstances described in Q&A 41, the annual retainer portion of director compensation has changed since the company's last proxy statement. The company filed a Form 8-K to disclose that change. Can the company simply refer to its prior proxy statement and the prior Form 8-K to satisfy the requirement that it disclose director fees?

A-42. Footnote 386 of the Adopting Release states that the company may reference its most recent Annual Report on Form 10-K or proxy statement, but is silent as to the ability to reference information in a Form 8-K. We recommend that the company incorporate by reference into, or include in, the new Form 8-K the relevant disclosure from the proxy statement and the prior Form 8-K.

Q-43. Each year a notional account for the benefit of each director is credited with $60,000 worth of company stock, based on the value of the stock on the date of the credit. Cash in an amount equal to the value of the stock credited to the account is paid at retirement. Each dividend payment on the stock results in automatic credits to the account of additional stock with a value equal to the dividend converted into the stock at the then

current market value. Assume that the charge under SFAS No. 123(R) each year is equal to the aggregate of the $60,000 per director. Are the dividend equivalents required to be reported in the "Nonqualified Deferred Compensation Earnings" column in the Directors Compensation Table?

A-43. On the basis that the value of the stock at any time reflects the right to receive expected future dividends, we believe that the right to dividends are factored into the charge and are not required to be reported again in the "Nonqualified Deferred Compensation Earnings" column, even though the investment is only a notional investment in stock.

Q-44. A company pays directors annual retainers in quarterly installments in advance, so that the last installment paid during the fiscal year is in respect of services to be rendered in the following fiscal year. Should this installment be included in the "Fees Earned or Paid in Cash" column in the Director Compensation Table since it was paid during the year?

A-44. No. This column should include only fees earned or paid in respect of services during the fiscal year to which the proxy disclosure relates.

Q-45. Is disclosure required under Item 404 of Regulation S-K for a given fiscal year with respect to a transaction between the company and a person who ceased to be a director during the year, but who was a director at the time of the transaction?

A-45. Disclosure of the transaction is not required under Item 404 of Regulation S-K. Disclosure of the transaction is nonetheless required pursuant to Item 407(a) of Regulation S-K. Whether the amount of the transaction is required to be disclosed depends on all the facts and circumstances.

Q-46. If a person (i) ceases to be a director during the fiscal year in question; or (ii) ceases to be a director after the fiscal year but before the filing of the proxy statement, does the company need to disclose the director's compensation in the Directors Compensation Table?

A-46. Yes in both cases.

Q-47. In the Beneficial Ownership Table, must the company include current directors who are not being renominated to the board?

A-47. Beneficial ownership information is required for any person who is a director on the date of the proxy statement, even if he or she is not standing for re-election. If a

director resigns before the proxy statement, the company could exclude that director from the disclosure.

OFFICER CERTIFICATION OF COMPENSATION DISCLOSURES

Q-48. The officer certifications required pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act, which are required to be filed with a company's Annual Report on Form 10-K, apply to disclosure in the proxy statement that is subject to "forward incorporation by reference" in the Form 10-K. This includes the CD&A and the tabular and other narrative disclosures about compensation (other than the report of the compensation committee). Can a company file the Form 10-K with the certifications attached prior to filing its proxy statement? Is it appropriate for the CEO and CFO to certify to the proxy disclosure prior its finalization?

A-48. These officer certifications must be filed with the Form 10-K and therefore there is no change under the new rules in this respect. In other words, for more than four years, CEOs and CFOs have been certifying prospectively about the incorporated proxy statement disclosures notwithstanding the timing difference in completing the Form 10-K and the proxy statement.

While most companies will continue to finalize the Form 10-K before the proxy statement, we believe that they are also modifying their disclosure controls and procedures such that, at the time of officer certification of the Form 10-K, an advanced draft of the proxy disclosure is available and has been reviewed by the compensation committee and reviewed by and discussed with the certifying officers. Companies are also adjusting their disclosure controls and procedures so that appropriate cross-checks of data can be completed prior to the completion of the 10-K, even though other procedures may be subsequently planned. Companies that include "sub-certifications" as part of the disclosure controls and procedures supporting the officer certifications are also relying on additional sub-certifications delivered at the time the proxy statement is finalized and that refer to the completed disclosures that have been reviewed by the compensation committee.

Q-49. What processes are being adopted to assist the CEO and CFO in certifying the CD&A and other compensation disclosures?

A-49. Practices vary considerably, depending on the circumstances of the company and the scope and nature of existing controls and procedures.

We note that many CEOs regularly attend compensation committee meetings, but most compensation committees also meet regularly in executive session without management present. Many CFOs do not regularly attend compensation committee meetings, and will continue not to do so. Most CFOs who do not regularly attend compensation committee meetings will be provided with the committee "pre-read" materials on an ongoing basis. Many companies also contemplate that the CEO and CFO will have the opportunity to review and discuss an advanced draft of the CD&A and other compensation disclosures with the compensation committee prior to certifying. Some companies are also planning "diligence" meetings by the CEO and CFO with the human resources leadership (or comparable group responsible for compiling relevant data and recommendations), as well as the disclosure committee and, where its participation in compensation decisions has been material, the compensation consultants for management and the compensation committee. In addition to interviewing the compensation consultants, some companies are also asking compensation consultants to review the draft disclosure and to comment as to the accuracy of matters within their purview.

Q-50. Must persons who were made CEO or CFO during 2006 certify as to the entire proxy, including portions of the disclosure relating to the period prior to their taking those positions?

A-50. Yes, as in prior years.

Q-51. How should a company's disclosure controls and procedures address the new rules?

A-51. Disclosure controls and procedures were previously relevant to compensation disclosures and whether adjustments will be appropriate depends on all the facts and circumstances. The following general points should apply to most companies:

- The compensation committee needs to be made part of the disclosure process and focused on disclosure to a greater extent than it has in the past, so as to ensure that its members' views are properly reflected in the disclosure, particularly in the CD&A.

- A comparison should be made between disclosure controls and procedures in, for example, the finance area and in the compensation area, with particular focus on document integrity and retention; the need for additional sub-certifications; documentation of information sources and verification and cross-check methodologies.

- The company should review its existing policies for elements of its compensation program (*e.g.*, equity grants, recoupment of incentive compensation, limitations on severance, perquisites) and calendar a periodic review of those policies by appropriate internal or board constituencies.

It is also important to recall that disclosure controls and procedures include an element of internal control over financial reporting. Whereas previously, much of the accounting and related data relating to executive and director compensation may have been maintained on informal spreadsheets, companies should now consider controls and procedures to protect the integrity of this data (*e.g.*, use of information systems that have appropriate "change management" protections to prevent unauthorized access to the information), if they have not already done so.

RELATED PERSON TRANSACTIONS

Q-52. What are companies disclosing about approval of related person transactions?

A-52. Issuers listed on NASDAQ are already subject to Rule 4350(h) requiring that any transaction disclosable under Item 404 of Regulation S-K be approved by the audit committee or other group of independent directors. Presumably, compliance with Item 404(b) of Regulation S-K will be a relatively easy matter for those companies. The analogous NYSE rule is set out in Rule 307.00 of the Listed Company Manual, which is precatory and somewhat vague.

Although it is still too early to tell how NYSE-listed companies are reacting to 404(b), our experience suggests that most companies are considering the adoption of written policies to address the review and approval of related person transactions, as well as procedures for gathering pertinent information. Clarity in this regard should facilitate consistency in the review of these transactions by the appropriate body, which may be a combination of the audit committee and all disinterested directors.

The first step is to determine what is already in place, including codes of conduct, internal policies and more formal governance structures. Many companies already have policies and procedures along the following lines: (i) one or more generally applicable codes of conduct that limit or prohibit related person transactions and impose a reporting obligations on officers and directors; (ii) an officer (*e.g.*, internal audit head, general counsel or compliance officer) specifically charged with the review of the transactions; and (iii) an oversight and approval mechanism at the board (or board committee) level. In some cases, a company may need to revise the definition of related

person transaction so as to conform to amended Item 404 of Regulation S-K. Given that there are fewer "bright line" exclusions from disclosure, companies will generally want to review a broader category of transactions for materiality. However, the elimination of the "bright line" exclusions does not affect the limitation on disclosures to "material" transactions. We would therefore expect that companies may find that, notwithstanding the elimination of the "bright line" exclusions, a number of ordinary course arm's-length transactions are not material and thus need not be disclosed, even where the amount of the transaction in question exceeds $120,000.

In addition, in some cases, companies may wish to increase the periodicity of review of these transactions. In all cases, companies should amend their director and officer questionnaires to reflect the new rules and to ensure that the questionnaires appropriately elicit information about all covered persons, including "immediate family members" and all affiliated entities.

Q-53. Is the compensation of executive officers who are not named in the Summary Compensation Table required to be reported under Item 404(a) of Regulation S-K?

A-53. Item 404(a) of Regulation S-K does not require disclosure of compensation that would have been reported under Item 402 had the person been an NEO so long as his or her compensation had been recommended for approval by the board (or committee) and the person is not an immediate family member of another related person. The Item 404(a) requirement is, in this regard, consistent generally with the NYSE and NASDAQ requirements for listed companies concerning compensation committee responsibility for executive officer compensation. *See, e.g.*, Section 303A.05(b)(i)(B) of the NYSE Listed Company Manual, which requires that "the compensation committee must have a written charter that addresses . . . the committee's purpose and responsibilities – which, at minimum, must be to have direct responsibility to . . . make recommendations to the board with respect to non-CEO executive officer compensation." As a result, it appears that companies that comply with NYSE or NASDAQ listed company requirements generally will not be required to disclose pursuant to Item 404(a) of Regulation S-K compensation arrangements with executive officers who are not NEOs.

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

PARIS
12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 45 63 68 88 Fax

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

MOSCOW
Cleary Gottlieb Steen & Hamilton LLP
CGS&H Limited Liability Company
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 258 5006
7 495 258 5011 Fax

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE
Theodor-Heuss-Ring 9
50668 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME
Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN
Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING
Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax

www.clearygottlieb.com