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## Executive Compensation: The New Executive Compensation Disclosure Rules Do Not Result in Complete Disclosure

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**EXECUTIVE COMPENSATION: THE NEW  
EXECUTIVE COMPENSATION DISCLOSURE  
RULES DO NOT RESULT IN COMPLETE  
DISCLOSURE\***

*Sean M. Donahue\*\**

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\* This Article reflects the views and considerations of the author and does not reflect the views of the Securities and Exchange Commission. The author did not work on the rulemaking while an employee at the Commission and was not at the Commission at the time of the rulemaking.

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## INTRODUCTION

Can a compensation consultant provide objective advice to the board regarding executives' pay packages when the same consultant provides other services to the company? Can investors understand how executives are compensated if companies do not disclose the level of performance that the company must achieve for executives to obtain certain amounts of compensation? Is the disclosure about executive compensation complete, absent full information regarding earnings on deferred compensation and perquisites?<sup>1</sup> This Article concludes that the answer to these three questions is a resounding no.<sup>2</sup> Although the Securities and Exchange Commission ("SEC") promulgated new executive compensation disclosure rules that governed the 2007 proxy season,<sup>3</sup> the foregoing issues were not adequately addressed by the new rules.

For example, when the board of the North Fork Bancorporation ("North Fork") hired Mercer Human Resources Consulting for compensation advice, Mercer suggested a golden parachute that would pay the top three executives \$288 million if the company underwent a change in control.<sup>4</sup> This package included a tax gross-up on restricted stock to the chief executive officer ("CEO") of \$44 million.<sup>5</sup> One pay

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1. See *infra* Part IV.

2. See *infra* Part V.

3. Executive Compensation and Related Person Disclosure, Securities Act Release No. 8732A, Exchange Act Release No. 54302A, Investment Company Act Release No. 27444A, 71 Fed. Reg. 53,158 (Sept. 8, 2006) available at <http://www.sec.gov/rules/final/2006/33-8732afr.pdf> [hereinafter Adopting Release].

4. Jesse Drucker & James Bandler, *North Fork Executives to Receive \$288 Million for Capital One Deal*, WALL ST. J., Mar. 14, 2006, at A1. "[A] golden parachute [is a] lucrative contract given to a top executive to provide lavish benefits in case the company is taken over by another firm, resulting in the loss of the job. A golden parachute might include generous severance pay, stock options, or a bonus." JOHN DOWNES & JORDAN ELLIOT GOODMAN, *DICTIONARY OF FINANCE AND INVESTMENT TERMS* (7th ed. 2006).

5. See Gretchen Morgenson, *Bank Deal's Payout Plan Questioned*, N.Y. TIMES, Mar. 15, 2006, at C1. A tax gross-up is an executive compensation tool that enables a company to cover the taxes on an executive's perks and benefits. Drucker & Bandler, *supra* note 4. In other words, "a tax buy-off is known as a 'gross-up' because beneficiaries receive 'gross' pretax sums rather than net post-tax sums." Daniel Gross, *Gross-Up? Gross Out. The Latest Abomination in CEO Pay*, SLATE, Mar. 15, 2006, <http://www.slate.com/id/2138119/?nav=tap3>. Restricted stock may be defined as follows: "Insider holdings that are under some other kind of sales restriction. Restricted

expert concluded that the CEO could potentially receive tax gross-up payments worth nearly \$111 million.<sup>6</sup> Essentially, the corporation would pay the taxes for a CEO taking home about \$185 million.<sup>7</sup> This pay package raises a red flag: it is unusual for a company to pay the taxes on restricted stock upon a change in control.<sup>8</sup> However, Mercer recommended this uncommon compensation package in a situation where it performed other services for the bank.<sup>9</sup> In fact, Mercer earned nearly \$1 million in 2002 and 2003 for its services as actuary to North Fork's cash-balance retirement plan.<sup>10</sup>

North Fork's payment to Mercer for these services certainly raises doubts as to whether Mercer provided objective advice to the board and highlights an area of disclosure that the new rules fail to address. In fact, this compensation package exemplifies the reality of the new rules. While the amendments are an overall improvement to the previous regime, they do not result in complete disclosure.

Part I of this Article describes the history of executive compensation and the disclosure of this compensation. Part II discusses problems with incomplete disclosure. Part III discusses the amendments to the executive compensation disclosure rules. Part IV discusses the four areas in which the rules fall short: a lack of information regarding compensation consultants, a lack of disclosure of target performance levels, a lack of disclosure of earnings on deferred compensation, and a lack of disclosure of perquisites. Part V proposes solutions for more effective executive compensation disclosure. Part VI concludes this Article.

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stock must be traded in compliance with special SEC regulations. Insiders are given restricted stock after merger and acquisition activity . . . ." Definition of Restricted Stock, <http://www.investopedia.com/terms/r/restrictedstock.asp> (last visited Sept. 9, 2007).

6. See Drucker & Bandler, *supra* note 4.

7. *Id.*

8. See Morgenson, *supra* note 5.

9. *Id.*

10. *Id.*

## I. BACKGROUND

## A. History Of Executive Compensation

Executive compensation is a relatively new area of study.<sup>11</sup> In fact, such compensation did not exist prior to the development of the modern corporation.<sup>12</sup> This form of business organization started with New Jersey legislation in 1896, and by 1901 the first major corporation was organized.<sup>13</sup> When corporations first formed and developed, they were led by entrepreneurs, exemplified by men like Henry Ford.<sup>14</sup> By the middle of the twentieth century, however, a new class of business actor evolved to run corporate America.<sup>15</sup> These individuals did not found companies, but rather made up an elite class of executives who held powerful positions in major corporations.<sup>16</sup>

Even though a corporation must disclose the pay for its top five executives,<sup>17</sup> the study of executive compensation typically focuses on the pay received by the CEO.<sup>18</sup> The CEO typically receives the highest pay of any person in the corporation, and this amount of compensation has increased over time.<sup>19</sup> By the 1950s, some CEOs were making relatively large salaries, but many salaries were not exorbitant.<sup>20</sup> As of 1960, the average CEO at a large corporation earned around \$190,000,<sup>21</sup> equivalent to approximately \$1.3 million today.<sup>22</sup> CEO pay rose quickly

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11. James A. Cotton, *Toward Fairness in Compensation of Management and Labor: Compensation Ratios, A Proposal for Disclosure*, 18 N. ILL. U. L. REV. 157, 158-62 (1997).

12. *Id.*

13. Carl T. Bogus, *Excessive Executive Compensation and the Failure of Corporate Democracy*, 41 BUFF. L. REV. 1, 8 (1993).

14. *Id.* at 9.

15. *Id.*

16. *Id.*

17. 17 C.F.R. § 229.402(3) (2007).

18. See generally LUCIAN ARYE BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004) (addressing the topic of executive compensation by solely analyzing the pay of CEOs).

19. *Id.* at 1.

20. See Bogus, *supra* note 13, at 10.

21. *Id.*

22. See U.S. DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, INFLATION CALCULATOR, <http://data.bls.gov/cgi-bin/cpiccalc.pl> (last visited Sept. 9, 2007) (follow "About this calculator" hyperlink).

The CPI inflation calculator uses the average Consumer Price Index for a given

during the 1960s and then slowed during the 1970s.<sup>23</sup> Between 1980 and 1993, executive compensation increased dramatically.<sup>24</sup>

From 1993 to 2000, the amount of executive compensation increased sharply.<sup>25</sup> In large companies, such as those representing the S&P 500, average CEO pay increased from \$3.7 million in 1993 to \$17.4 million in 2000.<sup>26</sup> Unsurprisingly, the aggregate pay of the top five executives increased from \$9.5 million to \$36.6 million in this time period.<sup>27</sup> There were similar trends in both the mid-cap and small-cap firms for both CEO pay and the pay of the top five executives.<sup>28</sup> Executive compensation peaked in 2000 and decreased during 2001, due mainly to the poor performance of the stock market.<sup>29</sup> Executive compensation levels, however, have been on the rise since 2001.<sup>30</sup> In fact, CEO pay increased 6% in 2006.<sup>31</sup>

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calendar year. This data represents changes in prices of all goods and services purchased for consumption by urban households. This index value has been calculated every year since 1913. For the current year, the latest monthly index value is used.

*Id.*

23. See Bogus, *supra* note 13, at 10.

24. *Id.* For example, during the 1980s CEO compensation rose by 212% in real terms. *Id.*

25. Lucian Arye Bebchuk & Yaniv Grinstein, *The Growth of Executive Pay 2* (The Harv. John M. Olin Discussion Paper Series, Paper No. 510, 2005), available at [http://www.law.harvard.edu/programs/olin\\_center/papers/pdf/Bebchuk\\_et%20al\\_510.pdf](http://www.law.harvard.edu/programs/olin_center/papers/pdf/Bebchuk_et%20al_510.pdf) (relying on compensation information from the standard ExecuComp database, which “includes all the S&P 500, Mid-Cap 400 and Small-Cap 600 companies). “Together, these firms constitute more than 80% of the total market capitalization of U.S. public firms.” *Id.* “Mid cap stocks typically have between \$1 billion and \$5 billion in outstanding market value” while “[s]mall cap stocks usually have a market capitalization of \$500 million or less.” Downes & Goodman, *supra* note 4, at 421, 655.

26. Bebchuk & Grinstein, *supra* note 25, at 3. This jump in pay represents an increase of 370% in real terms.

27. *Id.* This jump in pay represents an increase of 285% in real terms.

28. See *id.*

29. *Boss's Pay: The WSJ / Mercer 2002 CEO Compensation Survey*, WALL ST. J., Apr. 14, 2003, at R6.

30. See *id.*; see also *CEO Compensation Survey (A Special Report) – The Boss's Pay: The WSJ / Mercer 2005 CEO Compensation Survey*, WALL ST. J., Apr. 10, 2006, at R7.

31. Press Release, Equilar Inc., Equilar Study Finds S&P 500 CEO Pay Up 6.0 Percent to \$8.5 Million (Apr. 12, 2007), available at [http://www.equilar.com/newsletter/april\\_2007/2007\\_04\\_ect\\_pv.html](http://www.equilar.com/newsletter/april_2007/2007_04_ect_pv.html) (last visited Sept. 9, 2007).

*B. History of Executive Compensation Disclosure*

Before there were specific disclosure rules for executive compensation, requirements for disclosure were in Schedule A to the Securities Act of 1933 (“Securities Act”) and Section 12(b) of the Securities Exchange Act of 1934 (“Exchange Act”).<sup>32</sup> Both acts list the types of information that must be disclosed in registration statements.<sup>33</sup> After observing that executive compensation needed more specific attention, the SEC enacted its first executive compensation disclosure rules for proxy statements in 1938.<sup>34</sup> Since then, the Commission’s rules require companies to provide a narrative explanation of the levels of compensation, provide these levels of compensation in tabular form, or provide both types of disclosure.<sup>35</sup> For example, the Commission introduced the first tabular disclosure of executive compensation in 1942.<sup>36</sup> Ten years later, it introduced a separate table for pensions and deferred compensation, and in 1978, the SEC expanded tabular disclosure to cover all forms of executive pay.<sup>37</sup> Owing to the fact that the 1978 rules were overly complex, too detailed, and resulted in too many interpretive issues, the SEC issued new rules in 1983.<sup>38</sup> While the

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32. Adopting Release, *supra* note 3, at 53,160 n.44.

33. *Id.*

Item 14 of Schedule A called for disclosure of the “remuneration, paid or estimated to be paid, by the issuer or its predecessor, directly or indirectly, during the past year and ensuing year to (a) the directors or persons performing similar functions, and (b) its officers and other persons, naming them wherever such remuneration exceeded \$25,000 during any such year.” Section 12(b) of the Exchange Act as enacted required disclosure of “(D) the directors, officers, and underwriters, and each security holder of record holding more than 10 per centum of any class of any equity security of the issuer (other than an exempted security), their remuneration and their interests in the securities of, and their material contracts with, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer;” and “(E) remuneration to others than directors and officers exceeding \$20,000 per annum.”

*Id.*

34. *Id.* at 53,160 n.45.

35. *Id.*

36. *Id.*

37. *Id.*

38. Disclosure of Executive Compensation, Securities Act Release No. 6486, Exchange Act Release No. 20,220, Investment Company Act Release No. 13,529, 48 Fed. Reg. 44,467 (Sept. 29, 1983) [hereinafter 1983 Release].



1983 rules mandated some tabular disclosure, they primarily required narrative disclosure.<sup>39</sup>

After analyzing the effectiveness of limited tabular disclosure, the Commission adopted amendments to the executive compensation rules in 1992.<sup>40</sup> These amendments abandoned the primarily narrative disclosure approach for a highly formatted tabular one to facilitate the comparison of annual compensation among companies.<sup>41</sup> Because of the complexity of compensation programs, however, the Commission observed that the rigidity of the 1992 rules did not result in complete disclosure.<sup>42</sup>

In August 2006, after determining that the 1992 rules required significant changes, the SEC amended the executive compensation disclosure rules.<sup>43</sup> The new rules build on the 1992 amendments by providing broader tabular disclosure while simultaneously improving narrative disclosure.<sup>44</sup> Consequently, the amended rules most comprehensively govern executive compensation relative to previous regimes.<sup>45</sup> Yet despite their improvement, the new rules do not result in complete disclosure.<sup>46</sup>

## II. PROBLEMS WITH INCOMPLETE DISCLOSURE

There are two main problems with incomplete disclosure of executive compensation. First, shareholders cannot adequately influence the board of directors' decisions regarding executive pay without complete disclosure of such compensation.<sup>47</sup> Second, when shareholders, business media, social groups and professional groups do

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39. Adopting Release, *supra* note 3, at 53,160; *see generally* 1983 Release, *supra* note 38.

40. Adopting Release, *supra* note 3, at 53,161.

41. *Id.*

42. *Id.*

43. *Id.* at 53,160.

44. *See id.* (explaining that “[t]his approach will promote clarity and completeness of numerical information through an improved tabular presentation, continue to provide the ability to make comparisons using tables, and call for material qualitative information regarding the manner and context in which compensation is awarded and earned”).

45. *Id.*

46. *See infra* Part IV.

47. *See* BEBCHUK & FRIED, *supra* note 18, at 51-52 (arguing that shareholders' resolutions can influence executive pay practices).

not know the full measure of compensation paid to executives, there is a risk that executives and board members will be affected by so-called “outrage costs.”<sup>48</sup>

#### *A. Inability of Shareholders to Influence Board*

Complete disclosure of the entire amount of executive compensation informs both institutional and private shareholders about the actual levels of executive pay.<sup>49</sup> When this information is properly disseminated, shareholders can undertake two major actions to influence the amount of compensation paid to executives: place proposals directly on proxy statements pursuant to Rule 14a-8 of the Exchange Act<sup>50</sup> and/or launch “vote no” or “withhold the vote” campaigns.

##### *1. Shareholder Proposals*

The form and substance of shareholder proposals changed over time. While precatory resolutions on executive compensation were historically supported by social or labor activists and disfavored by institutional investors, the data from proxy resolutions show that in recent years, executive pay has become increasingly important to all shareholders.<sup>51</sup> In 2004, there were twenty-three shareholder proposals regarding pay for performance and in 2007 there were over sixty.<sup>52</sup> The percentage of shareholders who voted for these proposals increased from 19.2% to 35.1% during this period.<sup>53</sup> Shareholders regarded executive pay as the most important issue during the 2006 proxy season,<sup>54</sup> and a

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48. *Id.* at 64-66. Outrage costs refer to negative reactions by outsiders regarding high levels of executive compensation. *Id.* at 65.

49. *See* Adopting Release, *supra* note 3, at 53,159 (stating that the new rules will provide investors with a more complete picture of the compensation earned by a company’s executives).

50. 17 C.F.R. § 240.14a-8 (2007).

51. *See* BEBCHUK & FRIED, *supra* note 18, at 52. Precatory resolutions are not binding on the board even though they are supported by a majority of shareholders. *Id.*

52. *See* 2006 Postseason Report: Spotlight on Executive Pay and Board Accountability, 2006 Institutional Shareholder Services 3 [hereinafter Postseason Report]; Posting of L. Reed Walton to Risk & Governance Blog, [http://blog.riskmetrics.com/2007/07/preliminary\\_postseason\\_reports.html](http://blog.riskmetrics.com/2007/07/preliminary_postseason_reports.html) (July 13, 2007) [hereinafter Walton Blog].

53. *See* Postseason Report, *supra* note 52, at 4; Walton Blog, *supra* note 52.

54. *See* Postseason Report, *supra* note 52, at 2.

preliminary review of the 2007 proxy season shows this trend is continuing.<sup>55</sup>

Two of the most popular shareholder proposals during the 2006 and 2007 proxy seasons were “pay for performance” and “say on pay” resolutions.<sup>56</sup> Pay for performance resolutions base a CEO’s pay relative to his or her company’s total shareholder return.<sup>57</sup> Say on pay proposals give shareholders a non-binding advisory vote on executive compensation packages and first appeared on shareholders’ ballots in 2006; by 2007 there were more than forty such proposals, and the percentage of shareholders who voted for these proposals increased from 40% to 42.4% during this time period.<sup>58</sup>

Observing the popularity of say on pay resolutions, the U.S. House of Representatives passed a “say on pay bill” on April 20, 2007.<sup>59</sup> This bill requires corporations to give shareholders the right to vote on executive pay packages without having to use shareholder proposals.<sup>60</sup> Boards can disregard the results of the votes, however, because they are still non-binding.<sup>61</sup> It is worth mentioning that this bill tracks similar legislation in Britain and Australia, which mandates voting on say on pay and has fostered a cooperative dialogue among shareholders and boards about compensation.<sup>62</sup>

## 2. Vote No Campaigns

Shareholders can show their staunch disapproval of executive compensation packages by engaging in “vote no” or “withhold the vote” campaigns. While shareholders cannot vote against a director who is running unopposed, they can withhold their vote from one or more

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55. See Walton Blog, *supra* note 52.

56. See Postseason Report, *supra* note 52, at 2; Walton Blog, *supra* note 52.

57. See Postseason Report, *supra* note 52, at 15.

58. See Walton Blog, *supra* note 52.

59. See *House Votes to Give Investors Say on Executive Pay*, N.Y. TIMES, Apr. 21, 2007, at C4. The bill was drafted by Representative Barney Frank, a Democrat from Massachusetts and the chairman of the Financial Services Committee. It passed by a 269-134 vote. *Id.*

60. *Id.*

61. *Id.*

62. See Gretchen Morgenson, *Roadblocks To Greater Say on Pay*, N.Y. TIMES, Jan. 21, 2007, § 3, at 1.

directors up for election.<sup>63</sup> Although directors only need a plurality of votes to get elected, a substantial “withheld vote” in a director election demonstrates sharp shareholder criticism of executive pay packages.<sup>64</sup>

In 2006, investors withheld support for compensation committee members at many large companies, including Pfizer.<sup>65</sup> While the AFL-CIO and the Connecticut Retirement Plans and Trust Funds chastised the \$83 million retirement package for CEO Henry McKinnell, an investor group organized a “vote no” campaign against two Pfizer compensation committee board members.<sup>66</sup> Both members received a 21% withhold vote.<sup>67</sup> Similarly, ten of eleven directors at Home Depot received withhold votes ranging from 30% to 36% in 2006.<sup>68</sup> Home Depot investors were enraged that the company’s CEO had earned \$200 million in compensation between 2001 and 2005 while the company’s stock price dropped 13%.<sup>69</sup> The staggering number of shareholder protests through withhold votes should cause boards to reevaluate the amount of, and manner in which, executives receive compensation.

### *B. Lack of Social Accountability*

When shareholders, business media, social groups and professional groups know the amount of compensation paid to executives, the disapproval by these groups can result in “outrage costs.”<sup>70</sup> There are three main ways in which this public outcry might influence both the levels of executive compensation and the policies by which executive compensation is determined: through the market for corporate control, the labor market, and the social network.<sup>71</sup>

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63. Diane Del Guercio, Laura Wallis & Tracie Woidtke, *Do Boards Pay Attention when Institutional Investors ‘Just Vote No’? CEO and Director Turnover Associated with Shareholder Activism* 3 (U. of Tenn. Corp. Gov. Ctr., Working Paper, 2006), available at <http://www.corpgovcenter.org/Research2006/DoBGueWalWoi2006.pdf>.

64. *Id.*

65. See Postseason Report, *supra* note 52, at 5. Other companies include: UnitedHealth, Occidental Petroleum, Exxon Mobil, Clear Channel Communications, CA, and Home Depot. *Id.* at 5-6.

66. *Id.*

67. *Id.*

68. *Id.* at 6.

69. *Id.*

70. See BEBCHUK & FRIED, *supra* note 18, at 64-66.

71. *Id.*

In the market for corporate control, investors could view excessive compensation as a sign of director and manager indifference to shareholder interests.<sup>72</sup> As a result, shareholders will seek to divert power away from the board when presented with the opportunity to do so.<sup>73</sup> For example, in a proxy fight or hostile takeover, these investors would probably not support the incumbents.<sup>74</sup>

The sanctioning of excessive executive compensation has the potential to give directors and managers negative reputations.<sup>75</sup> This might affect future career prospects and lead to disapproval by social and professional groups.<sup>76</sup> Consequently, this public embarrassment and criticism can affect both the levels of executive pay and the means by which it is awarded.<sup>77</sup>

While outrage costs are a powerful constraint on executive pay, they deliver little influence on the levels of compensation unless all observers are familiar with the amount of, and the way that, executive compensation is awarded.<sup>78</sup> The new executive compensation disclosure rules now require disclosure of most of this information.

### III. OVERVIEW OF THE NEW EXECUTIVE COMPENSATION DISCLOSURE RULES

After proposing amendments to the executive compensation disclosure rules<sup>79</sup> and receiving 28,828 comments in response,<sup>80</sup> the SEC adopted amendments to the disclosure requirements for executive compensation and other corporate governance matters.<sup>81</sup> The new rules

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72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. Executive Compensation and Related Party Disclosure, Securities Act Release No. 8655, Exchange Act Release No. 3185, Investment Company Act Release No. 27,218, 71 Fed. Reg. 6542 (proposed Feb. 8, 2006), *available at* <http://www.sec.gov/rules/proposed/33-8655fr.pdf> [hereinafter Proposing Release].

80. Comments on Proposed Rule: Executive Compensation and Related Party Disclosure, <http://www.sec.gov/rules/proposed/s70306.shtml>.

81. *See* Adopting Release, *supra* note 3, at 53,158. In addition to amending the rules for executive compensation and certain corporate governance matters, the SEC also amended the requirements for disclosure of related party transactions and board

were designed to provide investors with a clearer and more complete picture of executive compensation.<sup>82</sup> The rules require increased discussion of a company's use of compensation consultants.<sup>83</sup> Moreover, the compensation committee of the board of directors must furnish a report stating that it reviewed and discussed the Compensation Discussion and Analysis section ("CD&A") with management.<sup>84</sup> The CD&A is a narrative description of a company's data regarding compensation policies and procedures reflected in the tables.<sup>85</sup> The SEC underscores that the Summary Compensation Table, however, remains the principal disclosure vehicle for executive compensation.<sup>86</sup>

#### A. Corporate Governance Disclosures

The SEC currently mandates more thorough disclosure regarding compensation consultants than it had in previous years.<sup>87</sup> This information is not required in the CD&A, but instead must be disclosed in the corporate governance section, which focuses on the resources utilized by the compensation committee in setting the amount of executive pay.<sup>88</sup> Each company must disclose the following: state any role of compensation consultants in determining the amount of compensation; identify such consultants; state whether such consultants are engaged directly by the compensation committee; describe the nature and scope of their assignment; and list the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.<sup>89</sup> Despite the breadth of this disclosure, it is still incomplete—the company is not required to disclose whether the compensation consultant performs other consulting services for management.<sup>90</sup>

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compensation. *Id.* However, this article is solely focused on the amendments to the executive compensation rules and certain corporate governance matters.

82. *Id.*

83. *Id.* at 53,205.

84. *Id.* at 53,168.

85. *Id.* at 53,160.

86. *Id.* at 53,169. This table shows compensation with respect to the last three fiscal years and discloses a single figure for total compensation. *Id.*

87. *Id.* at 53,205.

88. *Id.*

89. 17 C.F.R. § 229.407(e)(3)(iii) (2007).

90. See Letter from James F. Reda, Managing Dir., James F. Reda & Assocs., LLC, to Nancy M. Morris, Sec'y, SEC 4 (Apr. 6, 2006), available at

*B. Compensation Committee Report*

Under the new rules, a company's compensation committee must furnish a Compensation Committee Report.<sup>91</sup> This report is similar to the Audit Committee Report currently required in proxy statements.<sup>92</sup> In this section, the compensation committee needs to state that it discussed the CD&A with management, and that based on this review and discussion, it recommended to the board of directors the inclusion of the CD&A in the proxy statement.<sup>93</sup> Like the Audit Committee Report, the name of each member of the compensation committee has to appear below the disclosure.<sup>94</sup> Yet, unlike the Audit Committee Report, which has a separate section describing whether auditors are independent of management,<sup>95</sup> the Compensation Committee Report contains no separate section requiring disclosure of whether compensation consultants are independent of management.<sup>96</sup> Because compensation consultants might have conflicts of interest, the absence of such disclosure makes the new rules incomplete.<sup>97</sup>

*C. Compensation Discussion and Analysis*

The CD&A is a narrative overview which provides information about the company's compensation objectives, policies, procedures, and processes.<sup>98</sup> This section is designed to put into narrative context the disclosure provided elsewhere in the filing.<sup>99</sup> The CD&A is considered part of the proxy statement and any other filing that includes it.<sup>100</sup> The SEC deems the CD&A "soliciting material" that must be filed with the

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<http://www.sec.gov/rules/proposed/s70306/jfreda3948.pdf> [hereinafter Reda Comment Letter].

91. See Adopting Release, *supra* note 3, at 53,168.

92. *Id.* at 53,168.

93. *Id.*

94. *Id.*

95. 17 C.F.R. § 240.14a-101(9)(e)(1) (2007).

96. See Reda Comment Letter, *supra* note 90, at 3-4.

97. *Id.* at 4-5.

98. See Adopting Release, *supra* note 3, at 53,164.

99. *Id.*

100. *Id.* at 53,167.

Commission and therefore is subject to Regulation 14A or 14C and the liabilities of section 18 of the Exchange Act.<sup>101</sup>

The CD&A ought to explain the following: the objectives of the compensation program; what the compensation program is designed to reward; each element of compensation; why the company chooses to pay each element; how the company determines the amount for each element; and how each element fits into the company's overall compensation objectives.<sup>102</sup> To offer guidance to companies, the SEC lists several examples of the topics that might need to be disclosed in this section.<sup>103</sup> Since the rule requires disclosure of all material

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101. *Id.*

102. *Id.* at 53,164.

103. *Id.* at 53,165. Examples of such information include: (i) The policies for allocating between long-term and currently paid out compensation; (ii) The policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation; (iii) For long-term compensation, the basis for allocating compensation to each different form of award (such as relationship of the award to the achievement of the registrant's long-term goals, management's exposure to downside equity performance risk, correlation between cost to registrant and expected benefits to the registrant); (iv) How the determination is made as to when awards are granted, including awards of equity-based compensation such as options; (v) What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions; (vi) How specific forms of compensation are structured and implemented to reflect these items of the registrant's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal(s) or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified named executive officers or to all compensation subject to the relevant performance goal(s); (vii) How specific forms of compensation are structured and implemented to reflect the named executive officer's individual performance and/or individual contribution to these items of the registrant's performance, describing the elements of individual performance and/or contribution that are taken into account; (viii) Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment; (ix) The factors considered in decisions to increase or decrease compensation materially; (x) How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g., how gains from prior option or stock awards are considered in setting retirement benefits); (xi) With respect to any contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) at, following, or in connection with any termination or change-in-control, the basis for selecting particular events as triggering payment (e.g., the rationale for providing a single trigger for payment in the event of a change-in-control); (xii) The impact of the accounting and



information, however, a company can neither rely solely on disclosing information that relates to these examples nor use mere boilerplate disclosure.<sup>104</sup> A company must disclose all information that is material to its compensation objectives and policies, unless a specific exemption applies, such as the exemption for target performance levels.<sup>105</sup> This safe harbor for performance targets makes the new disclosure rules incomplete.<sup>106</sup>

#### D. Summary Compensation Table

The purpose of the Summary Compensation Table is to provide investors with a simplified and more comprehensible picture of total compensation and the various elements that comprise it.<sup>107</sup> This table is the primary disclosure vehicle for executive pay and was designed to capture all forms of executive compensation.<sup>108</sup> The Summary Compensation Table requires that a company disclose all executive compensation with respect to the last three fiscal years.<sup>109</sup> The portion of the Summary Compensation Table requiring monetary disclosure is reproduced below:<sup>110</sup>

Salary (c)	Bonus (d)	Stock Awards (e)	Option Awards (f)	Non-equity Incentive Plan Compensation (g)	Change In Pension Value and Non- qualified Deferred Compensation Earnings (h)	All Other Compen- sation (i)	Total Compen- sation (j)
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tax treatments of the particular form of compensation; (xiii) The registrant's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership), and any registrant policies regarding hedging the economic risk of such ownership; (xiv) Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies); and (xv) The role of executive officers in determining executive compensation. *Id.*

104. See Adopting Release, *supra* note 3, at 53,164.

105. *Id.* at 53,166; *see infra* Part IV.B.

106. See Letter from Richard L. Trumka, Sec'y-Treasurer, AFL-CIO, to Nancy M. Morris, Sec'y, SEC 2 (Apr. 5, 2006), available at <http://www.sec.gov/rules/proposed/s70306/aflcio040506.pdf> [hereinafter Trumka Comment Letter].

107. See Adopting Release, *supra* note 3, at 53,169.

108. *Id.* at 53,169.

109. *Id.*

110. *Id.* at 53,170.

The total compensation column (column (j)) is an innovative and crucial part of the new rules.<sup>111</sup> Prior to the amendments, securities analysts and investors were unable to determine an accurate figure for total compensation.<sup>112</sup> Moreover, they could not determine an amount of total compensation that was comparable across years for the same company or for the same year across different companies.<sup>113</sup> The new total compensation column tries to solve these problems by attempting to capture all of the compensation earned by executive officers.<sup>114</sup> It does so by aggregating in column (j) the total dollar value that is disclosed in columns (c) through (i).<sup>115</sup> In light of the way in which nonqualified deferred compensation earnings column (h) and perquisites column (i) are disclosed, however, the total compensation column will be understated.<sup>116</sup>

#### IV. PROBLEMS WITH THE NEW EXECUTIVE COMPENSATION DISCLOSURE RULES

The amended executive compensation disclosure rules do not result in complete disclosure because (1) information regarding the conflicts of interest of compensation consultants is lacking; (2) disclosure regarding performance target levels is lacking; (3) only above-market interest rate earnings on deferred compensation need be disclosed; and (4) only disclosure of perquisites exceeding \$10,000 is required.<sup>117</sup>

##### A. *Compensation Consultants' Conflicts of Interest*

The current relationship between compensation consultants and the compensation committee is similar to the relationship between auditors and the audit committee prior to the enactment of the Sarbanes-Oxley Act.<sup>118</sup> Before Sarbanes-Oxley, the auditing firms of the late 1990s generated large percentages of their revenue by providing non-audit

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111. *Id.*

112. Adopting Release, *supra* note 3, at 53,170.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* at 53,174-76.

117. *See infra* Part IV.A-D.

118. *See* Reda Comment Letter, *supra* note 90, at 5.

consulting services to companies.<sup>119</sup> As a result, auditors had an incentive to approve misleading accounting figures so that they could preserve and obtain more lucrative non-audit consulting contracts from management.<sup>120</sup> To prevent this conflict of interest the Sarbanes-Oxley Act limited the types of non-audit services that an accounting firm can provide to a company for which it performs an audit.<sup>121</sup> In fact, the Act eliminated the economic incentives for the auditors to conform to management's personal objectives during the audit.<sup>122</sup> However, this economic incentive was not eliminated for compensation consultants who perform services for both the compensation committee and management.<sup>123</sup>

Like the auditing firms of the late 1990s, compensation consultants stand to profit more from the work performed for management than from the services provided to the compensation committee.<sup>124</sup> This incentive is present because most human resources consulting firms are diversified.<sup>125</sup> In fact, out of the largest consulting firms in the United States, just one company provides only compensation consulting services.<sup>126</sup> Moreover, compensation consulting makes up a very small percentage of revenue for most diversified consulting firms.<sup>127</sup> For example, at a typical diversified consulting firm, compensation consulting revenue will be between 0.5% and 2% of total firm revenue.<sup>128</sup> Therefore, all other revenues come from non-executive compensation-related consulting services.<sup>129</sup>

As a result, the diversified consulting firm's impartiality is compromised when it provides executive compensation advice to the board and is retained by management for other services.<sup>130</sup> Consultants presumably support management's compensation decisions in order to

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119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.* at 1.

124. *Id.* at 5.

125. *Id.* at 6.

126. *Id.* at 5.

127. *Id.* at 7.

128. *Id.*

129. *Id.*

130. Letter from Peter C. Clapman, CEO, Governance for Owners USA Inc., to Nancy M. Morris, Sec'y, SEC 4 (Apr. 7, 2006), available at <http://www.sec.gov/rules/proposed/s70306/pcclapman6514.pdf>

preserve and obtain lucrative consulting contracts for matters other than executive compensation consulting.<sup>131</sup> Thus, they are less likely to be independent in their advice to the compensation committee because they are under pressure to produce compensation packages that satisfy management.<sup>132</sup>

### B. Target Performance Levels

Under the new rules, the SEC does not require companies to disclose performance target levels in the CD&A if such disclosure would result in competitive harm to the company.<sup>133</sup> A performance target level is a quantitative or qualitative performance-related standard considered by the compensation committee of the board of directors that an executive must meet to obtain a certain level of compensation.<sup>134</sup> Pursuant to the amendments, companies are exempt from disclosing performance targets involving confidential trade secrets or confidential commercial or financial information if the disclosure would result in competitive harm.<sup>135</sup>

In order to satisfy this exemption, the company must demonstrate to the SEC that it has met the same standard for confidential treatment that is used when the Commission decides whether to grant a confidential treatment request.<sup>136</sup> In effect, the rule maintains a safe harbor under which companies may exclude performance targets if the SEC finds that such disclosure would be competitively harmful to the company.<sup>137</sup>

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131. See Reda Comment Letter, *supra* note 90, at 7.

132. *Id.*

133. See Adopting Release, *supra* note 3, at 53,166.

134. *Id.*

135. *Id.*

136. *Id.* at 53,166-67.

While the instruction adopted . . . does not require a company to seek confidential treatment under the procedures in Securities Act Rule 406 and Exchange Act Rule 24b-2 with regard to the exclusion of the information from the disclosure provided in response to this item, the standards specified in Securities Act Rule 406, Exchange Act Rule 24b-2, Exemption 4 of the Freedom of Information Act and Rule 80(b)(4) promulgated under the Freedom of Information Act still apply and are subject to review and comment by the staff of the Commission.

*Id.* at 53,167 n.94.

137. Letter from Ann Yerger, Executive Dir., Council of Institutional Investors, to Nancy M. Morris, Sec'y, SEC 2 (Mar. 29, 2006), available at <http://www.sec.gov/rules/proposed/s70306/s70306-74.pdf> [hereinafter Yerger Comment Letter].

Exempting performance targets from the CD&A impairs the quality of information disclosed, however, because it makes the link between executive pay and company performance difficult to assess.<sup>138</sup>

Pay for performance is probably the most important issue for shareholders regarding executive compensation.<sup>139</sup> Yet, under the new rules, shareholders will not know the performance target levels that executives must meet to obtain a specified level of compensation.<sup>140</sup> Consequently, they cannot accurately determine whether executives are being paid for meeting these targets.<sup>141</sup> Because companies do not have to disclose the levels of compensation that are tied to the targets, nor disclose whether such targets were met, the owners of the firm will not be informed as to how and why executives are compensated.<sup>142</sup>

Moreover, shareholders can best judge the effectiveness of their board if they have access to information about performance targets.<sup>143</sup> Therefore, disclosure would help make compensation committees more accountable should they decide to provide bonuses or incentive pay even when performance targets are not met.<sup>144</sup> The exemption of performance targets is also unwarranted because shareholders, as the owners of the company, are entitled to know the levels of performance that must be achieved to earn the performance awards.<sup>145</sup> By exempting companies from making this type of disclosure, the Commission perpetuates shareholder ignorance about significant portions of a firm's compensation policies.<sup>146</sup> This exception undermines the purpose of the new rules because it leaves out a vital element of the company's compensation philosophy.<sup>147</sup>

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138. *Id.*

139. Trumka Comment Letter, *supra* note 106.

140. See Letter from the Honorable Barney Frank, Member, House Comm. on Fin. Servs., to Christopher Cox, Chairman, SEC 2 (Apr. 10, 2006), available at <http://www.sec.gov/rules/proposed/s70306/bfrank041006.pdf> [hereinafter Frank Comment Letter].

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. See Trumka Comment Letter, *supra* note 106.

146. See generally Trumka Comment Letter, *supra* note 106.

147. *Id.*

*C. Summary Compensation Table*

Under the new rules, the figure for total compensation will be understated for two reasons. The first reason is that earnings on deferred compensation only have to be disclosed at above-market interest rates.<sup>148</sup> The other reason is that perquisites only have to be disclosed to the extent that they exceed \$10,000.<sup>149</sup> Because both of these figures are part of the total compensation column,<sup>150</sup> the amount of total compensation will be understated.<sup>151</sup> In the Summary Compensation Table, nonqualified earnings on deferred compensation are disclosed in column (h), perquisites in column (i), and total compensation in column (j).<sup>152</sup> To highlight these portions of the Summary Compensation Table, the table is reproduced below:<sup>153</sup>

Salary (c)	Bonus (d)	Stock Awards (e)	Option Awards (f)	Non-equity Incentive Plan Compen- sation (g)	Change In Pension Value and Non- qualified Deferred Compensation Earnings (h)	All Other Compen- sation (i)	Total Compen- sation (j)
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*1. Nonqualified Deferred Compensation Earnings*

Under the new rules, the disclosure of deferred compensation earnings is limited to the amount earned at above-market interest rates.<sup>154</sup> The term “above-market interest” refers to interest earned in excess of 120% of the applicable federal long-term rate.<sup>155</sup> As of September 2007, this above-market interest would include interest earned at a rate that exceeds 6.13%.<sup>156</sup> This means that a company does

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148. See Adopting Release, *supra* note 3, at 53,174.  
 149. *Id.* at 53,176.  
 150. *Id.* at 53,170.  
 151. *Id.* at 53,176.  
 152. *Id.* at 53,170.  
 153. *Id.*  
 154. *Id.* at 53,174.  
 155. *Id.*  
 156. Rev. Rul. 2007-57, 2007-36 I.R.B. 532, available at <http://www.irs.gov/pub/irs-irbs/irb07-36.pdf> (last visited Sept. 9, 2007).

not have to disclose earnings on deferred compensation that accrue at an interest rate below 6.13%.<sup>157</sup>

An analysis of the earnings on deferred compensation at Analog Devices, Inc. (“Analog”) provides an example of how disclosing earnings at above-market interest rates results in incomplete disclosure. At Analog, the company’s CEO withdrew a previously undisclosed \$144.7 million from his deferred compensation account.<sup>158</sup> Under the rules in effect when this 2006 proxy statement was filed, Analog was not obligated to disclose this amount to investors.<sup>159</sup> Pursuant to the new rules, companies must disclose the amount of deferred compensation.<sup>160</sup> Yet, the rules only require disclosure of a portion of the interest earned on executives’ deferred compensation accounts.<sup>161</sup> For example, had the new rules been in effect when Analog’s CEO earned \$8.7 million in interest on the money in his deferred compensation account in 2005,<sup>162</sup> Analog would have been required to disclose only \$1.2 million of this interest.<sup>163</sup> As a result, total compensation would have been understated by \$7.5 million.<sup>164</sup>

## 2. Perquisites

Perquisites given to executives are disclosed in the All Other Compensation Column of the Summary Compensation Table (column (i)), and the dollar figure disclosed for these earnings is used to calculate the total amount of compensation.<sup>165</sup> Companies must disclose perks

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157. See Adopting Release, *supra* note 3, at 53,174.

158. See Gretchen Morgenson, *A ‘Holy Cow’ Moment in Payland*, N.Y. TIMES, Feb. 19, 2006, § 3, at 1; Analog Devices, Inc., Definitive Proxy Statement (Form 14A), at 28 (Feb. 8, 2006) [hereinafter Analog Proxy].

159. Morgenson, *supra* note 158.

160. Adopting Release, *supra* note 3, at 53,170.

161. *Id.* at 53,174.

162. See Analog Proxy, *supra* note 158, at 19.

163. *Id.* at 19 n.3. “SEC regulations consider the ‘market rate’ to be 120% of the applicable federal long-term rate, or AFR. Earnings credited to participants electing the fixed-rate investment option for fiscal year 2005 were calculated using an average interest rate of 6.48% and 120% of the average AFR was 5.57%.” *Id.* With earnings of \$8,743,912 at 6.48%, the total earnings on deferred compensation are \$134,936,914, and the earnings on this total at 5.57% are \$7,515,986. The company is only obligated to disclose above-market earnings of \$1,227,926.

164. See *supra* note 163 and accompanying text.

165. See Adopting Release, *supra* note 3, at 53,176.

unless the amount of such compensation is less than \$10,000.<sup>166</sup> Although the amendments to the rules for disclosing perquisites are an improvement compared to the old regime, the exemption causes the total compensation figure to be understated.<sup>167</sup>

There are two reasons why all perquisites should be disclosed.<sup>168</sup> The first reason is that any substantial threshold, especially one as large as \$10,000, provides a loophole for companies.<sup>169</sup> Firms can simply disaggregate perquisite compensation to qualify for the exemption by breaking the perks down into increments that are less than \$10,000.<sup>170</sup> For example, a firm could allocate \$9,000 for football tickets, \$9,000 for theatre tickets, and \$9,000 for basketball tickets, and disclose none of this information in the Summary Compensation Table.<sup>171</sup> Another permutation of this abuse could be as follows: a company could break down a car allowance into a car leasing allowance, a gas allowance, a car insurance allowance, and a travel allowance while not disclosing the total car allowance.<sup>172</sup> It is easy to imagine that under the new rules a company could have \$1,000,000 of perquisites broken down into 110 separate items each worth roughly \$9000, resulting in hundreds of thousands of dollars worth of perks remaining undisclosed.<sup>173</sup>

The second reason all perquisites should be disclosed is that certain perks might be a waste of corporate assets even absent a major impact on the total compensation column.<sup>174</sup> For example, a company could provide lavish office extras such as daily flowers and gilded umbrella

166. *Id.*

167. *See id.* (noting that the earlier rule permitted the omission of perquisites if the aggregate amount of such compensation was the lesser of either \$50,000 or 10% of the total annual salary and bonus).

168. Letter from C. William Jones, President and Executive Dir., Ass'n of BellTel Retirees, to Nancy M. Morris, Sec'y, SEC 4 (Apr. 10, 2006), *available at* <http://www.sec.gov/rules/proposed/s70306/cjones9947.pdf> [hereinafter Jones Comment Letter].

169. *Id.*

170. Letter from Kurt Schacht, CFA, Managing Dir., CFA Ctr. for Fin. Mkt. Integrity & James C. Allen, CFA, Senior Policy Analyst, CFA Ctr. for Fin. Mkt. Integrity, to Nancy M. Morris, Sec'y, SEC 8 (Apr. 13, 2006), *available at* <http://www.sec.gov/rules/proposed/s70306/jcallen041306.pdf>.

171. *See* Letter from Paul Hodgson, Senior Research Assoc., The Corporate Library, to Nancy M. Morris, Sec'y, SEC 2 (Mar. 10, 2006), *available at* <http://www.sec.gov/rules/proposed/s70306/phodgson032706.pdf> [hereinafter Hodgson Comment Letter].

172. *Id.* at 2.

173. *Id.*

174. Jones Comment Letter, *supra* note 171.



stands.<sup>175</sup> Regardless of the perquisite's significance on the total compensation column, the very fact of such a perk could signal the existence of other problems with the company's executive compensation policies.<sup>176</sup>

#### V. PROPOSED SOLUTIONS TO THE PROBLEMS WITH THE NEW DISCLOSURE RULES

The proposed solutions to the problems with the amended executive compensation disclosure rules are specifically designed to address the four problems with the rules. First, the Commission should require disclosure of all work performed by compensation consultants by requiring companies to disclose all fees received by these consultants.<sup>177</sup> Second, the SEC must insist upon disclosure of target performance levels after the conclusion of the performance period.<sup>178</sup> Third, the Commission needs to mandate disclosure of all earnings on deferred compensation and require disclosure of all perquisites.<sup>179</sup>

##### A. *Disclosure of All Work Performed by Compensation Consultants*

The Commission should require companies to disclose all of the work performed by compensation consultants, list the fees received for the work that is done, and state the nature of the work that is performed.<sup>180</sup> To accomplish this goal, the SEC ought to amend section 407(e) of Regulation S-K, and in so doing ask companies to provide a tabular disclosure of these fees.<sup>181</sup> The table should include the type of work performed by the compensation consultant and the fees received

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175. *Id.*

176. *See* Letter from Martha L. Carter, Senior Vice President and Managing Dir. of Corporate Governance, Institutional S'holder Servs., to Nancy M. Morris, Sec'y, SEC 3 (Mar. 28, 2006), *available at* <http://www.sec.gov/rules/proposed/s70306/mcarter9965.pdf>.

177. *See infra* Part V.A.

178. *See infra* Part V.B.

179. *See infra* Part V.C.

180. Letter from Brian T. Foley, Managing Dir., Brian Foley & Co., Inc., to Nancy M. Morris, Sec'y, SEC 2-3 (Apr. 10, 2006), *available at* <http://www.sec.gov/rules/proposed/s70306/btfoley4083.pdf>.

181. *See* Reda Comment Letter, *supra* note 90, at 7 (suggesting similar disclosure but suggesting that such disclosure should be included in the CD&A rather than as an amendment to section 407(e)).

by the consultant for this work.<sup>182</sup> To ensure a more comprehensive and textured response, however, the SEC cannot abandon narrative disclosure, and can ask companies to include such a description of the specific nature of the work performed in the footnotes to this table.<sup>183</sup>

This disclosure is appropriate because of the similarity between the current relationship among compensation consultants, management, and the compensation committee, and the relationship among auditors, management, and the audit committee prior to Sarbanes-Oxley.<sup>184</sup> In fact, this recommended disclosure is similar to the disclosure required in the Audit Committee Report.<sup>185</sup> Such disclosure is crucial to assure that auditors are truly independent of management.<sup>186</sup> Thus, by requiring a table for compensation consultants similar to the one included in the Audit Committee Report for auditors, investors will be better able to see whether compensation consultants are independent of management,<sup>187</sup> thereby compelling the compensation committee to ensure that compensation consulting advice comes without coercive strings attached.<sup>188</sup>

To assure independence, the tabular disclosure required by the suggested amendments to section 407(e) of Regulation S-K should result in the following table:<sup>189</sup>

EXECUTIVE COMPENSATION CONSULTING FEES AND ALL OTHER FEES		
	2007	2006
Executive Compensation Consulting Fees (a)	\$XXX	\$XXX
All Other Fees (b)	\$XXX	\$XXX
Total Fees (c)	\$XXX	\$XXX

In this table, companies would have to disclose the following information: under the caption Executive Compensation Consulting Fees, the aggregate fees billed for each of the last two fiscal years for

182. *Id.*

183. *Id.* at 3.

184. *Id.* at 5.

185. *Id.* at 7.

186. *Id.* at 5.

187. *Id.* at 7.

188. *Id.* at 7-8.

189. *Id.* This table is similar, but not identical, to the table provided in the Reda Comment Letter.

executive compensation consulting services rendered by the principal compensation consultant (row (a)); for fees disclosed under this category, the company would have to describe the nature of the services comprising the fees; under the caption All Other Fees, the aggregate fees billed in each of the last two fiscal years for products and services provided by the principal compensation consultant, other than the services reported in (row (a)); for fees disclosed under this category, the company would have to describe the nature of the services comprising the fees; and under the caption total fees, the sum of the amounts reported in rows (a) and (b).

*B. Disclosure of Target Performance Levels after the Conclusion of the Performance Period*

The SEC needs to mandate the disclosure of target performance levels after the conclusion of the performance period<sup>190</sup> by amending Instruction 4 to Item 402(b) of Regulation S-K to require disclosure after the performance related to the award is measured.<sup>191</sup> This increased disclosure would result in investors being better able to assess the link between executive pay and company performance.<sup>192</sup> While the disclosure of performance targets can result in competitive harm, the potential for this harm is mitigated if disclosure is required after the performance related to the award is measured.<sup>193</sup> Because competitors would also be required to publish information about performance targets, the competitive costs to the companies should equalize once all the information is disclosed.<sup>194</sup> In short, this disclosure will not result in competitive harm because companies and compensation consultants already have access to this information.<sup>195</sup> Moreover, because performance targets are generally based upon public information such as the company stock price or disclosed financial statements, requiring disclosure of targets will not place an undue burden on companies.<sup>196</sup> Thus, the Commission should require companies to disclose this information to give investors a better understanding of a company's

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190. See Yerger Comment Letter, *supra* note 137.

191. *Id.* at 3.

192. See Frank Comment Letter, *supra* note 140.

193. See Adopting Release, *supra* note 3, at 53,166.

194. See Frank Comment Letter, *supra* note 140.

195. *Id.*

196. See Trumka Comment Letter, *supra* note 106.

compensation policies, philosophies, and procedures.<sup>197</sup> Requiring disclosure after the conclusion of the performance period is appropriate because it addresses companies’ competitive concerns while providing shareholders with important information about executive compensation practices.<sup>198</sup>

To strike the appropriate balance between the competitive concerns of companies and shareholders’ access to information, the SEC should require companies to disclose the performance measure, the performance target, the actual performance, whether or not the target was achieved, and the amount earned from the performance. Amending Instruction 4 to Item 402(b) achieves the requisite balance among the interests of investors, the company, and the public.<sup>199</sup> The corresponding table should appear as follows:

Performance Measure	Performance Target	Actual Performance	Achievement	Amount Earned
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*C. Disclosure of All Earnings on Deferred Compensation and All Perquisites*

In its proposing release, the Commission recommended disclosure of all earnings on deferred compensation.<sup>200</sup> The SEC should have implemented the rules as proposed.<sup>201</sup> It should remedy this decision by amending Item 402(c)(2)(viii)(B) to require disclosure of all earnings on deferred compensation. In addition, this Item should also require separate footnote identification if such earnings exceed \$10,000.<sup>202</sup> The Commission should also adopt Proposed Instruction 5 to Item 402(c)(2)(ix), which permits a company to identify by footnote the portion of any earnings that it considered to be paid at an above-market

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197. See Yerger Comment Letter, *supra* note 137, app. at 2.  
 198. See Frank Comment Letter, *supra* note 140.  
 199. Yerger Comment Letter, *supra* note 137, app. at 3.  
 200. Proposing Release, *supra* note 79, at 6552.  
 201. “Such compensation must include, but is not limited to . . . all earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on non-qualified defined contribution plans.” *Id.* at 6612.  
 202. *Id.* at 6552.

interest rate.<sup>203</sup> The current rule, by enabling companies to skirt disclosure of all earnings on deferred compensation, allows firms to avoid disclosure of substantial executive pay.<sup>204</sup> This exemption also causes the total compensation figure to be understated. Consequently, the Commission should adopt the recommended amendment because it strikes the appropriate equilibrium between disclosing earnings that a company believes to be above-market and capturing all of the compensation paid to executives.

In addition to requiring disclosure of all earnings on deferred compensation, the SEC should require disclosure of all perquisites. To accomplish this goal, the Commission needs to amend Item 402(c)(2)(ix)(A) to eliminate the \$10,000 threshold for the disclosure of perks. Although the SEC acknowledges that the exclusion of perquisites results in an understated figure for total compensation, it justifies the \$10,000 threshold because of the potential burden on companies to track every benefit, no matter how small.<sup>205</sup> Yet, companies' accounting departments already track this expense; therefore, most firms have this information readily available.<sup>206</sup> Moreover, shareholders are entitled to know both the amount and types of perquisites to assess whether the board is wasting corporate assets.<sup>207</sup> Consequently, the SEC ought to adopt the recommended amendment because it provides necessary information to shareholders and results in a more accurate figure for total compensation.

## VI. CONCLUSION

Although the amendments to the executive compensation disclosure rules are an improvement over the previous regime, the new rules do not result in complete disclosure. Therefore, the Commission should require disclosure of all work performed by compensation consultants, all performance targets after the conclusion of the performance period, all earnings on deferred compensation, and all perquisites. While the SEC should be commended for the new rules, an exhaustive review of the

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203. *Id.*

204. *See* BEBCHUK & FRIED, *supra* note 18, at 314-15.

205. *See* Adopting Release, *supra* note 3, at 53,176.

206. *See* Hodgson Comment Letter, *supra* note 174.

207. *See* Jones Comment Letter, *supra* note 171.

2007 proxy season is likely to reveal some of the rules' deficiencies. This article addressed some of these shortcomings, but further inquiry into the sufficiency of the new rules is warranted.