



**CORPORATE WAVELENGTH**  
*The Corporate Governance, Risk, and Compliance Web Series*

Brought to you by Corporate Secretary and Foley & Lardner LLP

## Year Two of Expanded Executive Compensation Disclosure: War or Peace?

Thomas E. Hartman, Partner at Foley & Lardner LLP  
 Yvette M. VanRiper, Partner at Foley & Lardner LLP  
 David Scharf, Corporate Secretary and Associate General Counsel at  
 Baxter International, Inc.

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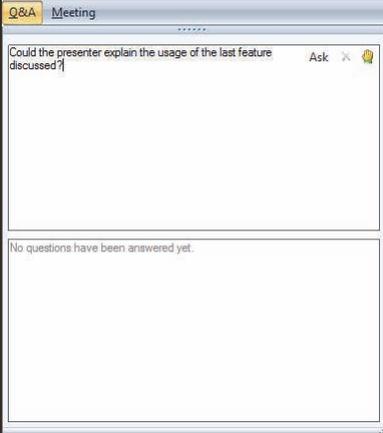
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## Today's Speaker

**Yvette M. VanRiper**  
Partner, Foley & Lardner LLP

- Member of the firm's Transactional & Securities Practice
- Represents issuers and underwriters in public debt and equity offerings
- Advises public companies regarding corporate governance matters and compliance with SEC regulations

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## Today's Speaker

**Thomas E. Hartman**  
Partner, Foley & Lardner LLP

- Member of the firm's Transactional & Securities Practice
- Practice focuses on corporate and securities law matters, including public equity and debt financings, M&A and VC
- Practice also focuses on business formation and governance, and federal and state securities law compliance counseling



## Today's Speaker

### David Scharf

Corporate Secretary and Associate General Counsel  
Baxter International, Inc.

- Joined Baxter in 2005 after serving as Associate GC for Guidant Corporation
- Was assistant general counsel with Sears, Roebuck and Co. prior to Guidant
- Handles board and securities matters, as well as corporate transactions at Baxter



## Today's Moderator

### Brendan Sheehan

Executive Editor, *Corporate Secretary*

- Editorial mission: To provide innovative and insightful analysis for corporate secretaries, general counsel and compliance officers
- *Corporate Secretary* is the leading source of information on matters relating to the SEC, Sarbanes-Oxley, D&O insurance, shareholder communications, proxy solicitation and voting, director education and compensation, listing requirements and entity management

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## Overview

November 7, 2006 – New Executive Compensation Rules Adopted; Effective for 2007 Proxy Season

Overview of new rules:

- Additional and improved principles-based disclosure regarding executive and director compensation
- Expanded tabular disclosure (now 7 tables), including summary compensation table, equity awards disclosure, post-employment compensation, director compensation

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## Overview (cont.)

- Significantly more narrative discussion: Compensation Discussion & Analysis describes objectives and goals of compensation program and material factors supporting compensation policies and decisions
- Additionally, rules require narrative disclosure of the “material factors necessary to an understanding” of the numerical information presented in each table

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## Overview (cont.)

October 9, 2007 – SEC Staff released “Observations” summarizing 350 Staff reviews of executive compensation disclosure

- Objective: The Staff is seeking “more direct, specific, clear and understandable disclosure”
- Explanations Required: CD&A should focus on “HOW” and “WHY” – the basis and context for granting executive compensation. Disclosure must be specific and provide fulsome analysis of compensation decisions
- Emphasis on Style: The Staff is focusing on the manner of presentation. Executive summaries and tailored tables or charts usually enhance overall disclosure




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## Manner of Presentation

- Standard: “clear, concise, and understandable” disclosure (Regulation S-K Item 402)
- “Add analysis” or “enhance” analysis does not necessarily mean “lengthen”; rather, the Staff prefers “shorter, more concise and effective discussion”
  - *“The disclosure in this section is dense, difficult to understand, and comprises a disproportionate amount of disclosure when compared to the rest of the information you provided . . . . In addition, you rely too heavily on the use of defined terms as a primary way of explaining the information and your use of footnoting to the various tables significantly impairs the readability of your disclosure. Please distill this information into concise disclosure of the material concepts and potential payouts that underlie these types of agreements and present your disclosure in a fashion that is readily understandable and that fits within your overall compensation discussion.”*




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## Manner of Presentation

- Emphasize the basis for compensation levels and awards and de-emphasize detailed discussions of compensation program “mechanics.” Avoid copying mechanics verbatim from compensation plan or employment agreements

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## Polling Question #1

Who is doing the first draft of CD&A for your firm?

- A) HR team
- B) Inside counsel
- C) Outside counsel

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## Format

- CD&A must precede compensation tables
- Charts, tables and graphs not required by rules are encouraged (e.g., potential payments upon termination or change in control)
- Supplemental tables or disclosures to the Summary Compensation Table are encouraged
  - Cannot be more prominent than the required Summary Compensation Table
  - Must not appear to be part of the Summary Compensation Table
  - Differences must be explained

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## Substance

- Compensation philosophy alone is insufficient. Discuss how the compensation philosophies result in the numbers presented in the required tables
- Discuss the overall mix of executive compensation and each element of pay. Many Staff comments request companies to discuss the extent to which one compensation element affects decisions made about other compensation elements



## Substance (cont.)

- *“Please provide analysis about how you determine the amount and, where applicable, the formula for each element of pay.”*
- *“Please expand your analysis of the elements and levels of compensation paid to the named executive officers. Throughout your CD&A and as to each compensation element, provide an analysis of how you arrived at and why you paid each particular level and form of compensation.”*
- CD&A should include any material differences in how individual compensation packages were formulated. If the Summary Compensation Table suggests that the policies and decisions for individuals may be materially different, those differences should be discussed



## Substance (cont.)

- *“Please provide a more detailed analysis of how and why the compensation of the CEO differs so widely from that of the other named executive officers.”*
- *“. . . [Y]our disclosure should specifically address the reasons Mr. Smith received an award equal to 88% of his annual salary in fiscal 2006 and the reasons Ms. Jones received awards . . . equal to 102% of her base salary in fiscal 2006, while your other named executive officers received payouts of amounts between 48% . . . and 66%. You should then address why the percentages set for each named executive officer were chosen and how such amounts fit within your overall compensation philosophy.”*

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## Polling Question #2

Are you disclosing specific performance targets for

- A) 2007 and 2008
- B) 2007 only
- C) Neither, as would cause competitive harm
- D) Neither, as not used or not material

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## Performance

- Avoid vague references to executive performance. Provide supporting details
  - *“To the extent you base compensation-related decisions on achievement of business objectives, individual performance, or other internal and external factors, please provide clear disclosure of the manner in which the Committee considered these factors when approving specific pieces of each named executive officer’s compensation package.”*
  - *“Your disclosure suggests that different elements of compensation (such as base salary and incentive compensation) are significantly impacted by individual performance. Provide an analysis of how individual performance contributed to actual compensation for the named executive officers, including specific contributions the compensation committee considered in its evaluation, and if applicable, how they were weighted and factored into specific compensation decisions.”*



## Performance Targets

- Performance targets are NOT mandatory for all companies — only if they are material to compensation decisions
- If disclosing targets (even material targets) would cause competitive harm, they need not be disclosed
- Follow-up comments from the Staff regarding disclosure of performance targets have focused on whether competitive harm would actually ensue from disclosure of performance targets



## Performance Targets (cont.)

- *“ . . . We note your response . . . regarding the competitive harm that would result from disclosure of targets; however, we continue to believe that each of the performance targets should be disclosed. Alternatively, provide us with a thorough and detailed analysis as to why disclosure of each of the performance targets would cause your company competitive harm. Your analysis should . . . address, as merely one example, why disclosure of targets (for a now-expired fiscal year) that are similar to categories of information contained in your publicly-available financial statements would cause the company competitive harm under the company’s particular facts and circumstances. Also explain to us in more detail how competitors would gain insight into your confidential business plan from disclosure of your targets and how such insight could result in competitive harm.”*

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## Performance Targets (cont.)

- The Staff is not objecting to subjective determinations based on targets, but disclosure should clearly lay out the way that qualitative inputs factor into compensation decisions
- The calculation methodology of any non-GAAP target must be fully disclosed

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## Benchmarking

- Benchmarking is basing compensation on compensation paid by other companies to their executives. If it is material to compensation decisions, then the benchmark and its components should be disclosed
- Details should be provided regarding the peers used for benchmarking and the compensation components considered
  - *“To the extent that you engage in benchmarking your performance against your specific industry peer group, a general industry peer group and a long-term incentive peer group, please identify the companies that comprise these peer or survey groups.”*

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## Benchmarking (cont.)

- Registrants should also disclose exactly how information gleaned from the benchmarking studies affected compensation decisions. If substantial discretion is exercised, then that should be disclosed
  - *“Please add disclosure addressing how you target each element of compensation against the comparator companies. Specify how each element of compensation relates to the data you analyzed from the comparator companies and discuss where you target each element of compensation against the peer companies and where actual payments fall within targeted parameters.”*

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## Benchmarking (cont.)

- *“. . . [P]lease further revise to explain how the results of the 2005 benchmarking study were and/or are used in connection with compensation decisions. For example, were they used in connection with establishing the terms of your employment agreements in early 2006? Are they still used in connection with compensation decisions? If so, how?*

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## Polling Question #3

Will your CD&A for 2007 be

- A) Longer
- B) Shorter
- C) About the same

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## Change-in-Control and Termination Arrangements

- Explain the structure and material terms of such arrangements. Explain how the provisions fit within the company's overall objectives. Also, provide discussion of how these contingent payments influenced decisions regarding other compensation elements
  - *“Please explain how you determine the appropriate payment and benefit levels under the various circumstances that trigger payments or provision of benefits under the arrangements relating to termination and change in control. Also, discuss the rationale for decisions made in connection with these arrangements and how they fit into your overall compensation objectives and affect the decisions you made regarding other compensation elements.”*

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## Compensation Consultants

- Disclose the material elements of instructions or directions the compensation committee gave to the compensation consultant along with a complete description of the nature and scope of the assignments of the consultant

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## Compensation Committee Report

- The Staff reminded some registrants to state whether the compensation committee reviewed and discussed CD&A with management

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## Related Person Transaction Disclosure

- Few comments were issued. However, the Staff reminded companies that they must disclose whether they have written policies and procedures for reviewing, approving and ratifying related person transactions
  - *“Please state whether your policies and procedures for the review, approval or ratification of any related person transaction are in writing and, if not, how such procedures are evidenced . . . . Please consider expanding the disclosure regarding your policies and procedures to discuss the standards to be applied under such policies and procedures.”*

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## Corporate Governance

- Staff comments focused on who was involved in making compensation decisions. For example, if an executive officer was involved, his/her role should be described
  - *“You have indicated that the compensation committee may solicit compensation recommendations from the chief executive officer. Please expand this disclosure to discuss fully the role of the chief executive officer in determining or recommending the amount or form of executive or director compensation . . . . Please consider discussing whether the chief executive officer works with the compensation committee in establishing measures, targets and similar items that affect the CEO’s compensation and whether the CEO retains the ability to call compensation committee meetings or meet with the compensation consultant on an individual basis.”*

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## Concluding Practical Advice

- Focus on “HOW” and “WHY”. Avoid focusing on the “mechanics”
- Remember that the “example” items in Regulation S-K Item 402(b)(2) should only be discussed if they are deemed “material”
- Staff comments that are seeking more information are not necessarily seeking lengthier disclosure
- The typical historic practice of having an assistant general counsel or outside law firm draft “disclosure” and a registrant’s financial staff drop-in “numbers” will NOT work anymore

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## Concluding Practical Advice (cont.)

- The compensation committee, in-house legal staff and outside advisors should work together to draft compensation disclosure that is fulsome and compliant



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**Thank you for your participation**

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