FENWICK & WEST LLP

Comments on the SEC's Proposed Changes to Executive Compensation and Related Party Disclosure Requirements

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Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Re: File Number S7-03-06
Release No. 33-8655; 34-53185

Dear Ms. Morris:

Fenwick & West LLP is pleased to submit this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comments on its Release No. 33-8655; 34-53185, File No. S7-03-06, entitled "Executive Compensation and Related Party Disclosure" (the "Release").

We appreciate the Commission's thoughtful and comprehensive proposal to revise existing disclosure requirements regarding executive compensation and related party transactions and agree that existing disclosure requirements are in need of updating. Our comments fall into three broad areas: those relating to the proposed amendment of Item 402 of Regulation S-K; those relating to the proposed amendment of the Current Report on Form 8-K; and those relating to the proposed amendment of Item 404 of Regulation S-K.

PROPOSED AMENDMENT OF ITEM 402 OF REGULATION S-K

Compensation Disclosure and Analysis – Minimizing Boilerplate

The Release requests comment as to changes that could be made to the proposal to avoid boilerplate disclosure in the proposed Compensation Disclosure and Analysis. We note that proposed Item 402(b)(1) requires that the analysis address six enumerated topics, and proposed Item 402(b)(2) lists 13 other items registrants should consider including in the report. In our experience, this type of exhaustive listing of actual and potential disclosure items can lead to a check-the-box approach both by registrants in preparing, and the Commission's staff in reviewing, the subject disclosure.

We believe that proposed Item 402(b) would be more effective in producing a clear, specific, individualized description of a registrant's approach to compensation if it described the disclosure requirement somewhat more broadly and omitted some of the detail. In particular, we recommend retaining four of the six elements of Item 402(b) – (i) (objectives of the programs), (ii) (what the program is designed to reward and not to reward), (iii) (elements of compensation) and (v) (how the amounts of each element are determined) – and eliminating elements (iv) and (vi) and the illustrative examples of Item 402(b)(2).

Officers Covered

Proposed Item 402(a) would mandate disclosure under Item 402 for all individuals who served as the registrant's principal financial officer during the year. The Release notes that the Commission believes principal financial officer compensation information is important to investors because the principal financial officer "provides certifications required in the registrant's periodic reports and has important responsibility for the fair presentation of the registrant's financial statements and other financial information."

While we agree that the principal financial officer has the important responsibilities noted in the Release, we respectfully disagree that providing Item 402 disclosure for principal financial officers who would not otherwise be included is useful to investors for two reasons. First, the general purpose of executive compensation disclosure is to inform investors about how the registrant compensates its most senior executives. Compensation level is used by some readers as a way to measure the importance of the executive to the company. Singling out any one executive officer (other than the principal executive officer) seems unwarranted. To do so would elevate his or her significance,

or diminish the significance of the other executive officers. Many executive officers have roles that are as important, or more important, to the success of the registrant's business. As a result, we recommend that principal financial officer disclosure not be specifically mandated by proposed Item 402.

Second, we believe that there is an important reason to distinguish between disclosing principal executive officer compensation as compared to disclosing compensation of other executive officers. Disclosing all principal executive officer compensation may be material to investors given the singular prominence of that officer in virtually all registrants. In addition, the principal executive officer is almost always a member of the board of directors and is more likely to have input into the compensation process than other officers. Principal financial officers are not, as a matter of course, any more likely to serve on a registrant's board than any other executive officer. For these reasons, we do not believe that it is appropriate to require that any principal financial officer, or for that matter any other executive officer other than the principal executive officer, be specifically included as a named executive officer.

Summary Compensation Table

Proposed Item 402(c) generally retains existing requirements that a registrant present elements of compensation in a Summary Compensation Table but proposes to modify the table in many ways. We have two fundamental comments relative to the proposed table.

Total Compensation Column. The first column of the proposed new Summary Compensation Table would show an aggregate dollar amount of total compensation for the years covered. We believe that the Total Compensation column, mechanically aggregating dollars and imputed dollar values from all columns in the table, will not produce meaningful information about executive compensation. Moreover, we believe that the effort to produce a single compensation amount will create the mistaken impression that all elements of compensation are of equivalent value.

Our main concern with the Total Compensation column is that it requires registrants to aggregate cash consideration – which is obviously fine since it is fungible – with the calculated value of non-cash items, particularly equity-based awards. But registrants will calculate the value of equity awards differently (thus eliminating comparability across registrants), based on their different assumptions and valuation methods. In addition, we believe that cash and non-cash compensation are fundamentally different types of executive compensation and that these differences should not be obfuscated in the interest of simplifying or expanding compensation disclosure.

Simple examples illustrate the point. First, executives at different companies receiving equal cash compensation and identical options to purchase the same number of shares would disclose different "total compensation" based simply on the specific trading characteristics of their employer's stock and the realization patterns on its options. Even if the two employers had identical stock trading characteristics and realization patterns on their options, their respective executives' disclosed total compensation would be different if the reporting companies used different assumptions in applying the Black-Scholes (or other applicable) formula. Second, a registrant with an executive who received $100,000 in cash compensation and a stock option grant at the fair market value that vests over a four-year period – with a Black-Scholes valuation of $200,000 – would disclose $300,000 under the Total Compensation column. A registrant with an executive who received $300,000 in current cash consideration would also disclose $300,000 under the Total Compensation column. We believe that this equivalency inaccurately compares the compensation of these two fictional executives.

We fully support clear, forthright disclosure of all the various forms of compensation in the revised Summary Compensation Table. We also support the proposal to ascribe a dollar value to equity awards using the methodology employed by the registrant in producing its financial statements. The new table will give investors ready access to comprehensive information about the compensation paid to company executives. Notwithstanding our belief about the inappropriateness of aggregating cash payments and the calculated value of other awards, we note that any investor who may find this aggregation relevant may easily sum up cash compensation and non-cash compensation values to reach an aggregate number.

In conclusion, we recommend that the Total Compensation column in the Summary Compensation Table be eliminated.

Stock Awards and Option Awards Columns. The Stock Awards and Option Awards columns of the Summary Compensation Table would require registrants to report the full value of stock awards to the respective recipients, computed in accordance with Statement of Financial Accounting Standards 123(R) ("FAS 123(R)") but without regard to vesting requirements typically associated with these types of awards. We believe that stock-based

compensation should be included in the revised Summary Compensation Table to the same degree that it is recognized in the registrant's financial statements under FAS 123(R) for the reasons discussed below.

We believe it is inappropriate to include in the Summary Compensation Table the full value of stock options or other equity awards made during a year if they vest over a longer period. Equity awards are generally structured as long-term compensation and are subject to vesting requirements so that the value of these awards is earned and realized, if at all, over several years. We believe it would mislead investors to report the full value of an unvested award as compensation in the year awarded. It is also inconsistent with the accounting required by FAS 123(R). The Financial Accounting Standards Board engaged in a thorough and extensive process in arriving at the methodology for reporting compensation expense for equity compensation awards; it ultimately determined to include in financial statements the value attributable to the portion of such awards that vest during the year. The proposed Item 402 disclosure would be out of step with compensation expense associated with the award in the registrant's financial statements. It would also cause wide year-to-year swings in reported compensation for a given executive, when in fact the executive is "earning" a consistent level of compensation. Finally, this approach would cause inconsistencies from year to year in the named executive officers a registrant is required to include in its Summary Compensation Table – solely based of the timing of equity awards, even if the number of shares vesting in any year is the same.

Moreover, we do not believe that it is appropriate to include material modifications of options (or option repricings) at the full value of the award as modified (or repriced) for purposes of the Summary Compensation Table or any supplemental tables. Although repricings themselves are now rare, modifications that may be deemed to be material occur more frequently. For instance, it is not uncommon to extend the post-termination exercise period of outstanding options. We believe that it would be more representative of the compensation to the executive – and therefore more meaningful to investors – to include only the incremental value resulting from the modification, consistent with the treatment in the registrant's financial statements and pursuant to FAS 123(R), and only to the extent that an option or grant award vests or is vested for the year. In these situations, the full value of the award as modified represents neither the cost to the registrant or its shareholders nor the benefit to the executive.

For these reasons, we believe that stock-based compensation should be included in the revised Summary Compensation Table to the same degree that it is recognized in the registrant's financial statements under FAS 123(R).

Narrative Disclosure to Summary Compensation Table and Subsidiary Tables

As part of its proposed requirement of narrative disclosure to contextualize the tabular disclosure of the three principal compensation tables, the Release proposes requiring compensation disclosure of up to three employees who are not executive officers of the registrant but whose total compensation exceeded that of any named executive officer. The positions and total compensation would be disclosed, without naming the employee. We believe that this information is of minimal value to investors.

Weighing against this modest benefit to investors is the risk of significant disruption to registrants resulting from disclosures about highly compensated employees. In our experience, most companies and most individual employees go to some lengths to avoid sharing compensation information – within the company's employee base and with people outside the company. Any company could find itself at a disadvantage when competing for key talent if it was required to disclose publicly the total consideration paid to them, and public companies would be at a disadvantage to private companies in this regard. For smaller registrants in particular, disclosure of the job title will be virtually the same as disclosure of the employee's name. We believe that the risk of having to disclose this type of potentially disruptive disclosure is enhanced by the provision of the proposed rules that all options and other equity awards be valued for the purpose of the Summary Compensation Table in the year of grant. If a registrant has a policy, for example, of making equity awards every other year to executives, it could easily be the case that non-officer employees receiving awards in the intervening years would have reportable compensation that exceeds that of any named executive officer.

For the foregoing reasons, we believe it is not appropriate to require registrants to disclose compensation information regarding non-executive officer employees.

Severance and Change-in-Control Arrangements

Proposed Item 402(k) provides for new and detailed disclosures about a registrant's severance and change-in-control arrangements, including specific dollar amount of payments that may be made to an executive officer upon termination or change in control of the company. A registrant would also be required to disclose the assumptions behind payment estimates where payment is uncertain. For example, this proposal would require a registrant to disclose whether it would provide Internal Revenue Code Section 280G tax indemnification to an executive officer upon a change in control. Actual payments to an executive officer are required to be included in the appropriate year in the Summary Compensation Table under both current rules and proposed rules.

We agree that improved disclosure about payments to executive officers upon termination or change in control is appropriate and that such disclosure should include more specific discussion of possible Section 280G indemnification liability. However, we do not believe that registrants should be required to disclose assumptions made for purposes of making Section 280G calculations including, but not limited to, assumptions about reasonable compensation or the value of non-competition agreements. This information is of little, if any, value to investors and requires opinions of experts to develop.

Accordingly, we believe that, in providing a range of potential liability, registrants should be permitted and encouraged to state generally that assumptions were made with respect to Section 280G payments, but they should not be required to provide detailed disclosure about those assumptions.

Director Compensation

Our comments above regarding the Total Compensation, Stock Awards and Option Awards columns of the Summary Compensation Table apply equally to the corresponding columns of the Director Compensation Table required by proposed Item 402(l).

PROPOSED AMENDMENT OF FORM 8-K

The Commission has proposed moving the requirements for disclosure of executive officer and director compensation arrangements from Item 1.01 of Form 8-K to Item 5.02 Form 8-K. In connection with this proposal, the Commission requested comment on the question, "Is there a particular benefit to receiving information regarding employment compensation on a current basis rather than annually or quarterly?" In light of the expanded annual disclosure requirements contemplated in the Release, we think that it is indeed appropriate to revisit the relevance and usefulness of current reporting of compensation arrangements for executive officers and directors.

It has been our experience that complying with the executive compensation disclosure obligations under Item 1.01 of Form 8-K has been enormously time consuming for registrants and, as noted in the Release, has produced voluminous, fragmented disclosure that is frequently not material. We believe that an investor can best understand, and an issuer can best describe, a company's executive compensation program in the context of the full Item 402 disclosure required in a proxy statement or Form 10-K, as the case may be. We further believe that discrete changes to specific elements of an executive's compensation are rarely, if ever, sufficiently meaningful to investors to justify the filing of a current report. We note that under existing rules a new agreement with a named executive officer and a material agreement and material changes to an existing agreement with any executive officer would all have to be filed as exhibits to the registrant's next quarterly or annual report. Also, under Item 5.02 of Form 8-K, any arrangement with any new officer within the class of officers included in subsection (c) of the Item would be disclosed. And, of course, any change in executive compensation that would be likely to have a material affect on a registrant's operating results would be a known trend or an event that would change the relationship between a registrant's costs and revenues that would be disclosed in the registrant's next periodic report under Item 303 of Regulation S-K.

In light of all of the foregoing, we believe that providing Form 8-K current disclosure regarding changes in the compensation of existing executive officers and directors does not provide a benefit to investors that justifies the cost to the companies in which they have invested.

PROPOSED AMENDMENT OF ITEM 404 OF REGULATION S-K

In the Release, the Commission proposed significant changes to Item 404 of Regulation S-K. We comment on three of the topics raised by the Commission.

Delineation of Reportable Related Party Transactions

Item 404(a) currently requires disclosure about transactions between the registrant and a related party where the related party has a direct or indirect material interest in an amount exceeding $60,000. Item 404(b) currently requires

disclosure of relationships between the registrant and entities with which directors or nominees are affiliated, either by serving as an executive officer or by greater-than-10% equity ownership of the other entity. Item 404(b) disclosure is required if the amount of the transaction exceeds five percent of either party's revenues for the last full fiscal year. A longstanding telephone interpretation of the Staff of the Division of Corporation Finance provides that if a transaction need not be reported because it falls under the five percent test of Item 404(b), it is not required to be reported under 404(a) as a related party transaction, even if it involved payments in excess of $60,000.

Proposed Item 404 would retain the main characteristics of current Item 404(a), but increase the disclosure threshold to $120,000 from $60,000. It would also eliminate Item 404(b). As a result, any transaction involving more than $120,000 would require disclosure if any of the registrant's directors, nominees, executive officers or five percent stockholders has a "material" interest in the transaction. Proposed Instruction 8 to Item 404(a) provides that a person is not deemed to have a material interest merely by serving as a director of the other party, but no such presumption exists for a person serving as an executive officer of the other party.

The consequence of this regulation will be that if a member of the registrant's board of directors serves as an executive officer of an entity with which the registrant engages in a transaction involving consideration of more than $120,000, the registrant may have to disclose that transaction. We appreciate that under the new formulation, the registrant would be required to make a principles-based judgment about the materiality of the director's interest in the transaction with the entity for which the director serves as an executive officer. However, we are concerned, where the only quantitative guidance is a $120,000 transaction threshold, that a registrant will feel compelled to track all transactions of that dollar value and make a separate materiality judgment about each. This compares with the current requirement to track transactions with a dollar value of five percent or more of revenue of either party. For large companies with worldwide operations and board members who are executives of other large companies with worldwide operations, this new test would hugely increase the number of transactions to be monitored.

We believe that it would be appropriate to maintain some aspect of the current threshold tests of Item 404(b) for those cases in which a registrant's director is an executive officer or 10% security holder of the counterparty to a transaction.

If the Commission's goal is to move Item 404 to a more principles-based disclosure analysis, we would suggest that subsection (b) be retained, perhaps with a lower percentage of revenue as the threshold, for example, three percent of either party's revenue. The revised subsection (b) that we propose would provide that the director or nominee would be deemed not to have an indirect material interest in a transaction that is less than three percent of either party's revenues, and for transactions in excess of this amount, the registrant must decide if the director's indirect interest is material.

In conclusion, we believe that the Commission should retain some aspect of the current threshold test of Item 404(b) for related party transaction disclosure.

Disclosure of Proposed Transactions

The Release proposes to amend Item 404(a) to require disclosure of a "transaction" or "currently proposed transaction" with a related party. We respectfully submit that expanding the types of covered transactions to include those that are "currently proposed" will create an extremely difficult disclosure requirement with which to comply. In practice, it is not clear when a contemplated or potential transaction might become a "currently proposed" transaction. Nor is it clear what disclosure would be required if a currently proposed transaction is abandoned. Further, since Item 404 covers commercial transactions between the registrant and other entities with which the registrant's directors are affiliated, one can easily envision situations in which disclosing a proposed transaction would be commercially disadvantageous to one or both parties to the proposed contract. At a minimum, competitors would be made aware of the potential transaction. It is common practice for parties negotiating a commercial arrangement to agree not to disclose the fact of negotiations. If a potential transaction occurs at the time the registrant is making an Item 404 disclosure, the registrant could find itself forced to breach its nondisclosure agreement, further interfering with a normal commercial arrangement.

For these reasons, we believe that the words "or any currently proposed transaction" should be eliminated from proposed Item 404(a).

Definition of Related Party

As proposed, Item 404 defines "related person" to include the covered person (e.g., executive officer, director, and director nominee), specific relatives of the covered person, and any person "sharing the household" of that covered

person. It is not clear what arrangements are contemplated by the term "sharing the household" of the executive officer, director or nominee. If it involves an assessment of a person's residence, must the sharing be for some minimum period of time? For individuals with multiple households, are all situations required to be assessed? For the sake of certainty similar to that provided by the family relationships spelled out in the balance of the definition, we recommend that the Commission revise the definition to include those persons residing in the covered person's home with whom or over whom the covered person has a legally recognized duty of care, such as a guardianship.

We would be pleased to respond to any questions regarding these comments. Please feel free to contact the undersigned or Horace Nash at (650) 988-8500.

Respectfully Submitted,

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Daniel J. Winnike

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