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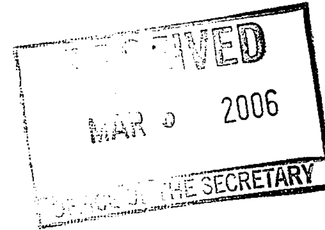

Nancy M. Morris
Secretary
Securities & Exchange Commission
100 F Street, NW
Washington, D.C. 20549-9303

February 28, 2006

Re: File S7-03-06
SEC Release 33-8655; 34-53185

Dear Ms. Morris,

This letter contains my comments with regard to the proposed amendment to the Executive Compensation Disclosure rule issued by the Securities & Exchange Commission on January 27, 2006.

I am an attorney and CPA by training and spent my professional career providing executive compensation consulting services to both public and private businesses and their respective boards of directors. I spent 16 years of my career as a partner in a 'big-4' accounting firm and 6 years as a principal in one of the largest compensation consulting firms in the world. While I retired from active practice two years ago, I feel that my training and professional experiences can be of some benefit to the Commission as it considers changes to the proxy disclosure rules for executive compensation. I am neither representing the views of my former firms, nor any particular client.

As general matter, I feel the staff has done an admirable job in setting forth the objectives for executive compensation disclosure and then providing a well thought out comprehensive framework for meeting those objectives. Yet, I want to share with the staff two specific positions set forth in the proposed amendment that I believe fail to achieve the stated objectives:

I. The determination of the value disclosed in the Summary Compensation Table under columns (f) and (g) titled "Stock Awards ($)" and "Option Awards ($)" Pages 2 – 13

II. The proposed elimination of the Performance Graph Pages 14 - 16

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I. Value of Stock Awards and Option Awards

A. Summary Compensation Table.

The current proxy disclosure rules require a Summary Compensation Table but do not require the value of the various compensation components be added together and disclosed as "Total Compensation." In fact, the current rules only require the number of shares under option granted during the fiscal year disclosed in the Summary Compensation Table without disclosing a dollar valuation for such options in that table.

The proposed amendment would require within the Summary Compensation Table a separate valuation column for each component of executive compensation including "Stock Awards" and "Option Awards" and a "Total Compensation" column that would contain the sum of all such compensation components (section 229.402(c)).

Requiring a summing of all elements of executive compensation-- cash, benefits and equity-- is quite appropriate especially since the value of the equity compensation component can, in many cases, dwarf the cash compensation components. This will clearly simplify executive compensation disclosure and put all executives on the same disclosure footing regardless of a company's philosophy of balancing between the cash, benefits and equity compensation elements.

B. Proposed Valuation of Option Awards.

The proposed amendment provides the following with regard to the valuation to be included in the "Option Awards" column of the Summary Compensation Table:

> "(vii) For awards of stock options… the aggregate grant date fair value computed in accordance with FAS 123R applying the same valuation model and assumptions as the registrant applies for financial statement reporting purposes…" Section 229.402(c)(2)(vii).
>
> "Under FAS 123R, the compensation cost is initially measured based on the grant date fair value of an award. The key measurement principle behind the accounting standard, measuring stock-based payments at grant date value, is also followed in our proposal…" Pages 32, 33 of the general explanation of the amendment.

It is quite easy to understand why the staff proposes to take this approach. After a bloody, prolong 20-year battle over the proper GAAP treatment to be accorded stock options for audited financial statements, who in their right mind would want to re-open that can of worms. The last thing the SEC wants to do, I suspect, is show any doubts over the hard fought victory of FAS 123R. Quite understandable, and certainly politically correct.

Yet, the staff readily admits that the Summary Compensation Table is not a GAAP financial statement and the Commission may, and in fact does propose to deviate from FAS 123R where it better serves compensation reporting purposes:

> "... We are in effect proposing an approach that subscribes to the measurement method of FAS 123R based on grant value, but that also provides for immediate disclosure of compensation as preferable for compensation reporting purposes to the timing of recognition of compensation cost for the company's financial statement reporting purposes [spreading the amount over the vesting period as required by FAS 123R]..." Page 33 of the general explanation.

There are a variety of other ways the staff proposes to distinguish option valuation for compensation reporting and financial statement reporting, e.g., no distinction between equity and liability type incentives, no reversal of the valuation in the event of forfeiture, no discount valuation where the option is subject to a market type condition, no incremental valuation in the event of modification or repricing.

I am suggesting in this letter, that the use of *the measurement method of FAS 123R*-- the use of *grant value,* in the Summary Compensation Table is also not preferable for compensation reporting purposes even though it is GAAP for financial statement purposes. I am not suggesting that the FAS 123R can of worms be reopened; rather, I am suggesting that a different measurement method would better serve the compensation reporting purposes as explained and illustrated below.

1. FAS 123R: Valuing the Opportunity

The underlying principle of FAS 123R is that the *compensatory event* with regard to an employee stock option occurs *at the date of grant* and virtually everything that follows the grant (with the exception of vesting) is irrelevant. In short, FAS 123R values *the opportunity* provided by the grant of a stock option and disregards the interim or ultimate benefit that may come from that opportunity.

- The ultimate fact that the stock price never appreciates after the option grant and expires without any benefit to the executive is ignored—the executive received an opportunity at the date of grant and that opportunity had a value and that value is treated as an expense of the employer at the date of grant. FAS 123R

- The ultimate fact that the stock price triples in value after the option grant and the executive receives a benefit at option exercise well in excess of the opportunity value at grant is ignored—the executive received an opportunity at the date of grant and that opportunity had a value and that value is treated as an expense of the employer at the date of grant. FAS 123R

Throughout the 20-year bloody debate over the proper accounting treatment to be accorded an employee stock option, both sides readily agreed that this *opportunity value* determination is *an estimate*, an educated estimate to be sure, but an estimate just the same. While GAAP financial statements contain many appropriate estimates (e.g., depreciation, allowance for bad debt, goodwill impairment, and now equity compensation), I suggest that in a Summary Compensation Table, where compensation is attributable to a named individual, an estimate, even an educated estimate, is inappropriate. The Summary Compensation Table should deal in economic reality, not projections or estimates.

2. Suggested Alternative: Valuing the Annual Benefit Derived from the Opportunity

I would suggest that a more appropriate value to include under the "Options Award" column in the Summary Compensation Table would be the value of the annual benefit derived from any outstanding option during the fiscal year rather than the value of the opportunity estimated at the date an option is granted:

> "The accrued value (positive or negative) derived *during the current fiscal year* from all of the executive's unexercised stock options regardless of when such options were granted."

Under this valuation methodology, there would be 3 valuation components for Stock Options included in the Summary Compensation Table, under column (g):

- With regard to options held at both the beginning and end of the year, the change in option spread due to stock price changes over the year; plus
- With regard to options exercised during the year, the change in option spread due to stock price changes from the beginning of the year to the date of exercise; plus
- With regard to options granted during the year, any option spread as of the last day of such grant year.

Similarly, there would be 3 valuation components for Stock Awards included in the Summary Compensation Table, under column (f):

- With regard to restricted stock (or RSUs, phantom stock, etc.) held both at the beginning and end of the year, the change in stock value of such stock due to stock price changes over the year; plus
- With regard to restricted stock that vests during the year, the change in stock value of such stock due of to stock price changes from the beginning of the year to the date of vesting; plus
- With regard to restricted stock granted during the year, the value of such stock as of the end of such grant year.

While vesting rights for options would not affect the valuation, the total value of options for a named executive would be footnoted to indicate what percentage of such total value is vested at year-end.

Even though the Summary Compensation Table should not contain the option opportunity value, the *supplemental tables* proscribed in proposed section 229.402(d) and (e) which require tabular information on equity and non-equity awards *granted during the fiscal year* should add a column for the FAS 123R opportunity value for each equity and option grant.

3. Comparison of the Two Valuation Methodologies: Meeting the Executive Compensation Disclosure Objectives

In this section, I will compare the option valuation methodology suggested in the proposed amendment ("Proposed Amendment") with the "Alternative Valuation" methodology that I suggest with regard to 4 disclosure objectives:

- Consistency of valuation methodology for each compensation component listed in the Summary Compensation Table
- Transparency, simplicity and clarity
- Logical, intuitive and fair representation of executive's economic compensation
- Ease of assessing a company's adherence to a pay for performance philosophy

(a) Consistency of Valuation Methodology for Each Compensation Component

As stated above, the Proposed Amendment values the opportunity presented by the grant of a stock option. Nevertheless, it does use opportunity valuation with regard to any other compensation component included in the Summary Compensation Table.

For example, the Proposed Amendment does not include in column (h) of the Summary Compensation Table the value of the opportunity granted in a non-stock based long-term incentive plan. The opportunity presented by such a grant is disclosed in the Supplemental Table described in Section 229.402(d) *in the year of grant*. But only the benefit actually earned from such an opportunity is included in column (h) of the Summary Compensation Table in a later year when such benefit is actually earned.

In short, the Summary Compensation Table only contains the value of the benefit derived from the opportunity; the opportunity in the year of grant and the range of possible future outcomes is initially only disclosed in the Supplemental Table.

Also, most companies at the beginning of a year provide their senior executives with an annual incentive bonus *opportunity* that typically lays out a matrix of performance objectives and corresponding bonus opportunities. Often these plans provide a "target bonus award" for accomplishing a level of expected performance. One might conclude that the value of the opportunity offered at the beginning of the year is the "target bonus award" but the ultimate benefit derived from this opportunity could be anywhere from 0% to 200% of such target award. The Proposed Amendment clearly requires the value of the benefit derived from the bonus opportunity be included in column (e) of the Summary Compensation Table, rather than the value of the opportunity. The value of the opportunity of an annual incentive plan would presumably be described in the Compensation Discussion & Analysis narrative as proscribed by proposed section 229.402(b) or in a footnote to column (e) of the Summary Compensation Table.

(b) **Transparency, Simplicity and Clarity**

Based on a document word search, the roots of the words "transparency" "simplicity" and "clarity" are mentioned over 90 times in this SEC Release. For example:

- "... to provide investors with a clearer and more complete picture of compensation earned... (pages 1 and 8)
- "...best methods of communicating clear, concise and meaningful information about executive and director compensation..." (page 9)
- "...promote clarity and completeness of numerical information..." (page 10)
- "...clear, concise and understandable for investors..." (page 14)
- "...to provide clarity and comparability..." (page 15)
- "...to provide a clearer and more logical picture of total compensation..." (page 23)
- "...the clearer and more complete picture it would provide to investors..." (page 24)
- "...and would simplify the presentation..." (page 25)
- "We propose to modify the Summary Compensation Table to provide a clearer picture of total compensation." (page 27)
- "...to simplify the Summary Compensation Table and eliminate confusing distinctions..." (page 39)
- "...simplify and clarify the requirements..." (page 133)
- "improved transparency in executive and director compensation would affect investors' decision-making..." (page 191)
- "...the amendments would clarify, consolidate and simplify the requirements for all public companies..." (page 218)

Some have said that the primary purpose of the entire project is to create clarity, simplicity and transparency of executive compensation through the proxy disclosures.

I suggest that the use of the opportunity valuation methodology in the Proposed Amendment is the antithesis of clarity, simplicity and transparency.

If you randomly selected 100 shareholders from any public company and provided each with all of the valuation components of an option grant, that is, you provided them with:

- the value of the stock at date of grant,
- the strike price,
- the volatility of the issuing company,
- the company's dividend history,
- the risk-free rate of interest,
- the legal and expected term of the option, and
- the company's employee turnover rate and option exercise history broken down by various employee demographics,

I suggest that not one of the shareholders would be able to tell you the value of the option opportunity to be disclosed in the proxy.

Alternatively, if you gave the 100 shareholders the company's FAS 123R valuation of the option, I suggest that none of them would be able to tell you how the number was determined. Why not? Because the FAS 123R valuation is determined in a black box—black—opaque, not transparent. Certainly not simple nor clear.

Contrast that with the Alternative Valuation methodology I have suggested. Take the same 100 shareholders and tell them that an executive was granted a 100,000 share option with a strike price of $10 early in the current year and the value of the stock is $15 on the last day of the year. I suggest that all 100 shareholders could tell you pretty quickly how much compensation the executive earned during the year from his stock option. Why? Because that is the same methodology shareholders use to determine their own gain from holding stock. No black box. No complicated formula. Simple. Clear. Transparent.

(c) **Logical, Intuitive and Fair Representation of an Executive's Compensation**

I contend that the use of the FAS 123R valuation methodology on an individual executive basis will cause illogical, counter-intuitive and unfair representation of an executive's compensation for the fiscal year and could unduly inflame the shareholders and media with regard to executive compensation. The best was to explain my position is with a series of hypothetical examples:

> **Example I:** Assume a CEO held a stock option at the beginning of the year that was $1,000,000 in the money and during the year the stock price appreciation resulted in the option becoming $6,000,000 in the money. Assume further that the CEO did not receive any new stock option grant during the year.
>
> Under the SEC's proposed valuation, the CEO would have no Stock Option compensation reflected in the Summary Compensation Table, even though his stock option spread grew by $5,000,000 during the year.

Reflecting this $5,000,000 option compensation in the Summary Compensation Table, I contend, is logical, intuitive and is a better representation of reality than reflected no stock option compensation at all for the year.

Example II: Assume a CEO held a stock option at the beginning of the year that was $5,000,000 in the money and during the year the stock price dropped dramatically resulting in the option falling 'under water.' Assume further that the CEO received a new stock option on the last day of the current year having an opportunity (FAS 123R) value of $2,000,000, but not in the money at year-end.

Under the Proposed Amendment, the CEO would have $2,000,000 of Stock Option compensation reflected in column (g) of the Summary Compensation Table, even though his beginning of the year $5,000,000 stock option spread was wiped out during the year and his option granted at the end of the year is also not in the money. Shareholders and the media would undoubtedly be incensed by the greed of such a CEO who received significant equity compensation in a year when shareholders suffered such a dramatic loss. Executive compensation critics would have a field day proclaiming the lack of 'pay for performance' given the sizable increase in the executive's pay reflected in the Summary Compensation Table in a year in which total shareholder return of the Company was significantly negative.

I am not suggesting that the CEO and management team should not be held accountable for the company's stock performance, but I am suggesting that disclosing $2,000,000 as the CEO stock option compensation is not a fair representation of the CEO's compensation for the year and it is inflammatory.

Under the Alternative Valuation method I am proposing, a $5,000,000 loss would be included in column (g) of the Summary Compensation Table and the $2,000,000 opportunity value of the new option grant would be included in the Grants of All Other Equity Awards Supplemental Table. I suggest that this is more logical and reflective of reality than including $2,000,000 in column (g) of the Summary Compensation Table. And a lot less inflammatory.

Am I just describing a situation that rarely occurs? Hardly. Check out just about any company during the 2001 - 2002 time frame. Shareholders lost significant wealth from their stock ownership and executives lost significant wealth from their carried interests (i.e., unexercised stock options and restricted stock) and yet under the Proposed Amendment, these executives would reflect positive equity compensation if they received a new stock option grant during the year.

Example III: Assume two CEOs at two different companies, each of whom receive an annual stock option grant with a $1,000,000 FAS 123R opportunity value each year for 5 year. Assume further that the first CEO's company stock never appreciates during the 5 year period, whereas the second CEO's company stock price appreciates at a 25% a year rate.

Under the Proposal Amendment, each CEO's stock option compensation reflected in column (g) of the Summary Compensation Table would be $1,000,000 in each of the 5 years. And yet the first CEO has not seen a dime of option profit over the course of the 5 year period. His shareholders and the media would undoubtedly wail about his naked greed and the size of his annual performance pay in spite of his lackluster performance on behalf of his shareholders. In reality, I suggest the Summary Compensation Table as proscribed by the Proposed Amendment overstates his compensation by $5,000,000 over the five year period.

On the other hand, the second CEO's compensation in the fifth year is clearly understated in the Summary Compensation Table, because his aggregate benefit in the fifth year alone derived from all five option grants well exceeds the $1,000,000 reflected in column (g) in that year. This is probably true in the fourth and third year as well. Interestingly, his column (g) equity compensation of $1,000,000 is probably overstated in years 1 and 2.

In short, using the FAS 123R *opportunity valuation* method for valuing individual stock options and stock awards leads to illogical, counter-intuitive, misleading and inflammatory results. For some executives, it overstates their equity compensation economic benefit for the year, and for others it understates their economic benefit.

In contrast, using the *value of the benefit* derived from the opportunity for individual stock options and stock awards leads to a more logical, intuitive and reasonable reflection of economic compensation reality.

(d) Pay for Performance Philosophy.

Executive compensation critics and professional gadflies are constantly bemoaning the lack of connection between executive pay and performance. Based on my professional experience, I can attest to a number of companies that set soft annual bonus performance goals or waived missed performance targets resulting in "pay in spite of performance."

But the use of the valuation method in the Proposed Amendment distorts and overstates the lack of connection between *equity pay* and *shareholder performance* with regard to stock options and, to a lesser extent, with regard to stock awards.

Stock options are perfectly aligned with shareholder gain—no stock price performance, no executive gain. The only time they are misaligned is when all of the executive's options are under water. When they are above water executive gain *and* executive loss flow in tandem with shareholder gain *and* shareholder loss.

And yet, well recognized compensation "experts" attempt to show that the relationship between an increase in CEO total compensation and the increase in total shareholder return (TSR) performance is only slight. Pay goes up in spite of lackluster share price performance they contend. But a substantial cause of concluding this lack of connection

between executive pay and TSR is the use of the methodology the Proposed Amendment would prescribe—valuing the opportunity of a stock option or a stock award in the year of grant rather than the value of benefit derived from that opportunity in future years.

Example II, above, illustrates this point precisely. The CEO pay goes up by $2,000,000 in a year when TSR is dramatically lower. See, that proves it-- no relation between pay and TSR! Great straw man. We use stock price appreciation or depreciation to gauge CEO performance, but use opportunity grant value to gauge CEO pay. Of course there is no pay and performance connection. But the reality is, the CEO *stock option benefit* during the year went down by $5,000,000, not up by $2,000,000. There is significant pay and performance connection between stock options and executive pay, but using grant opportunity value distorts this relationship.

4. Downside of Alternative Valuation

Described above are the reasons I suggest that valuing the benefit derived from the opportunity in the Summary Compensation Table is preferable to valuing the opportunity in the year of grant. What are the downsides of such a preference?

(a) Inconsistent with FAS 123R.

The primary problem of not using stock option opportunity valuation for compensation purposes is the inconsistency of using stock option opportunity valuation for financial accounting purposes.

> As explained above, the Proposed Amendment already recognizes that option valuation for financial accounting purposes is different from compensation reporting purposes and the Proposed Amendment contains a number of differences between the respective treatments. (See page 3 of this letter.)
>
> I would suggest that the purposes of the Summary Compensation Table on the one hand, and an audited financial statement of the registrant on the other, are quite different. An estimate of the current value of the opportunity reflected in hundreds of thousands of stock options granted by an enterprise to hundreds or even thousands of employees has very little in common with disclosing one individual's salary, bonus, benefits and incentive compensation. Estimates are quite common and appropriate in audited financial statements. I suggested they are inappropriate where one individual's income is being disclosed. By contrast, using the value of the benefit actually derived during a fiscal year is not an estimate; it is economic reality as of the end of the fiscal year.
>
> Very few, if any, readers of the Summary Compensation Table are going to understand that the dollars reflected under the columns marked "salary" or "bonus" or "non-stock incentive plan compensation" are inherently different from the dollars marked as "option awards"—that is, the former can be spent by the

executive today, while the latter, being a mere opportunity, cannot be spent today and, possibly, may never be able to be spent. This distinction is not transparent to most if not all of the proxy readers. It certainly is not apparent to the media.

In short, it is not unreasonable to use one valuation method for reporting the annual compensation of five named individuals and use another, more sophisticated valuation method for reporting the financial operations of a multi-billion dollar enterprise.

(b) Could Result in "Negative Total Compensation"

Under the Alternative Valuation method, during a year of significant stock price decline, the resulting *loss* in "Stock and Option Awards" reflected in columns (f) and (g) of the Summary Compensation Table could well result in negative Total Compensation reflected in column (c). This may be quite confusing to the reader of the table.

Confusing, yes, but a much better reflection of the executive's economic reality at a time when company stock price significantly declines in value during the year.

I suggest that the Summary Compensation Table be reorganized to better recognize this possible circumstance (i.e., significant decline in stock price) as well as the opposite circumstance—significant increase in stock price:

First, I would suggest combining columns (f) and (g) and moving it to the last column of the table and titling it: "Benefit/ Detriment this year from Holding Stock Awards and Options"

Next, I would add a new column just to the right of the Total column, titled: "Total Non Stock Compensation." This column would contain a subtotal of all columns except the stock column and would clarify that the executive's cash and benefit compensation is quite positive even though the loss for the year on equity awards may result in a negative Total compensation. Shareholders can easily understand this result since it quite possibly conforms to their own financial circumstances—positive salary, bonus and benefits but significant unrealized capital loss for the year.

In short, I suggest that it is a good thing to illustrate that executives share a similar downside with shareholders in determining their total compensation.

As an aside, the concept of negative compensation already exists under the Proposed Amendment. Section 229.402(c)(2)(ix)(A) requires inclusion in column (i) of the Summary Compensation Table:

"All earnings on compensation that is deferred ... including such earnings on non-qualified defined contribution plans."

Twenty years ago most nonqualified deferred compensation plans provided an interest factor to be applied to executives' deferred compensation balances resulting in only 'positive' annual earnings. Today most nonqualified deferred compensation arrangements are structured as 'phantom' or 'mirror' 401k savings plans that permit executives to select among various equity or fixed income investment vehicles for their deferred compensation. In years when the overall stock market is down (e.g., 2001 – 2002), most executives who selected equity investments incurred significant 'negative earnings' on their deferred compensation balances similar to many employees with 401k savings plans.

These 'negative' earnings would be reflected in column (i) of the Summary Compensation Table and in column (d) of the Nonqualified Defined Contribution and Other Deferred Compensation Plans table.

(c) Could Complicate the Process of Determining Market Competitive Executive Compensation

Compensation Committees and their executive compensation consultants traditionally use opportunity valuation methods similar to FAS 123R to determine both market competitive total pay and to set competitive option grant levels for the management team. The Total Compensation column (c) and the Stock and Option Awards column (f) and (g) of the Summary Compensation Table will not reflect opportunity valuation under the Alternative Valuation method.

The primary objective of compensation committees and their executive compensation consultants should be to set their executive pay *opportunities* at a level competitive with pay *opportunities* offered by comparably situated market competitors. In other words, look to competitive opportunities offered, not competitive benefits received from past opportunity offerings.

For example, in determining how many options to grant an executive of one company, the relevant market competitive data is the opportunity value (FAS 123R) of options granted to comparable executives at competitor companies, not the annual or ultimate benefit such comparable executives received from previous option grant opportunities.

The same is true with regard to setting annual bonus opportunities. It's not what comparable executives were paid at year end, but rather the value of what they were offered at the beginning of the year (i.e., the target bonus).

In other words, the compensation committee and the executive compensation consultant have a different objective from the typical reader of the Summary Compensation Table. The former is looking forward, that is providing competitive opportunities, while the latter is looking backward, assessing executive pay received based on past performance delivered.

In short, under the Alternative Valuation method, the compensation committee and its executive compensation consultant would piece together an executive's total compensation *opportunity* not by looking strictly at the Summary Compensation Table, but rather by adding:

- Salary reflected in column(d) of the Summary Compensation Table
- All Other Compensation reflected in column (i) of the Summary Compensation Table
- Target Annual Bonus Opportunity as set forth in the CD&A or in the footnote or narrative accompanying the Summary Compensation Table *(but not the amount reflected in column (e)).*
- Target Cash-Based Long-Term Incentive Awards reflected in column (i) of the Grants of Performance-Based Awards Table *(not the amount reflected in column (h) of the Summary Compensation Table)*
- Grant Date Value of Stock or Option Awards (FAS 123R opportunity value) reflected in column (f) of the Grants of Performance-Based Awards Table or in column (h) [to be added under Alternative Value proposal] of the Grants of All Other Equity Awards *(but not the amount reflected in the Summary Compensation Table under the Alternative Valuation proposal).*

(d) Option Benefit Reported in One Year Can Be Eliminated in a Future Year.

Under the Alternative Valuation method, the option or stock award compensation reported in one year can be reversed in a subsequent year if stock prices rise and then fall. This inherent volatility can be confusing to the reader of a Summary Compensation Table especially where the table will reflect a 3-year history for each named executive.

Compensation volatility is inherent in compensation that by design tracks the stock price changes of the employer similar to the employer's shareholders. That is the objective—make executives think like a shareholder and volatility is part of the risk/ reward proposition. The fact is that shareholders today do not believe executives experience both the upside and downside that they experience and the Summary Compensation Table under the Alternative Valuation proposal can disabuse them of this erroneous perception.

Use of an opportunity valuation as suggested by the Proposed Amendment, or exercise valuation as suggested by others, eliminate this volatility but ignores the reality that executives in fact experience such volatility between the date of grant and the date of exercise.

II. The Elimination of the Performance Graph

Section 229.402(l) of the Executive Compensation rule *before* the adoption of the Proposed Amendment requires a Performance Graph plotting the total shareholder return of the registrant over a 5 year period *as compared to* the total shareholder return of a competitive peer group and a broader index of companies.

The Proposed Amendment would eliminate the Performance Graph disclosure:

> "Further, given the widespread availability of stock performance information about companies, industries and indexes through business related Web sites or similar sources, we believe that the requirement for the Performance Graph is outdated particularly since the disclosures in the Compensation Disclosure & Analysis regarding the elements of corporate performance that a given company's policies might reach is intended to allow broader discussion than just that of the relationship of compensation to the performance of the company as reflected by stock price." Pages 21, 22 of the general explanation.

I understand and support the elimination of reports, tables and graphs that are redundant and superfluous, but I strongly submit that the elimination of this very simple 'picture' of *relative* TSR performance because it will be discussed in 'a thousand words' in the CD&A is truly questionable reasoning. A picture illustrating management's shareholder performance relative to competitors is better than words, even plain English words.

There are two primary reasons I support the retention of the Performance Graph:

- The importance of this comparative performance measure itself, and
- Its impact it has on setting management performance pay levels

Relative TSR:
The Ultimate Measure of Management Performance

Companies use a wide variety of measures to evaluate the performance of the enterprise and therefore, the performance of the senior executive officers, including:

- Growth in revenues, earnings, earnings per share, EBITDA, cash flow
- Growth in the percentage return on assets, equity, capital
- Growth in "economic value"
- Improving operating margins
- General and administrative cost control or not exceeding budgeted expenses
- Attaining specified strategic objectives (e.g., customer/ employee satisfaction)

One thing each of these measures has in common is that they are all "means" to an "end"/ key drivers (means) of shareholder value enhancement (end). Success in any or all of these measures is of little value to shareholders if the marketplace does not recognize such success in enhanced shareholder value.

Does this mean that shareholder value enhancement is the best measure of management performance? Of course not, because many things influence share price beyond management performance and most of them are way outside the control of management, such as changes in interest rates, overall economic conditions, overall political conditions and even the weather. Share price can go up even if management performance is mediocre. Share price can go down even if management exceeds all of their targets for key performance measures.

But *Relative Total Shareholder Return* neutralizes most of the uncontrollable factors since all competitors are subject to the same economic, political and metrological environment during the year. It is the purest form of isolating one management team's performance against another management team's performance within an industry or sector. In fact, it is the one measure that is not purely historical since share performance is based on both history and perceived future prospects.

During my professional career, I have witnessed every conceivable "yah-but" from senior management in assessing company performance—

- "yah we missed our EPS goal, but we really exceeded our diversity goal;"
- "yah we missed our revenue goal, but we really hammered our ROE goal;
- "yah we missed our earnings goal, but our spending in R&D is just about ready to launch a variety of new and profitable products."

"Yah-buts" just do not work very well with Relative TSR performance, because the efficient market is aware of all your "buts" as well as your competitors' 'buts' and the foot race illustrated in the Performance Graph still has your company trailing the competitors.

The general explanation cited above indicates that proxy readers can construct their own performance graph based on data available on the internet. That's probably true for 50% of the information required in the proxy. In addition, as described more fully below, it is quite educational for management to construct and disclose the chart themselves rather than force shareholders to do it on their own.

The general explanation cited above also indicates that the CD&A will focus on a broader discussion of corporate performance measures than just stock price performance, i.e., 'yah-buts." I am all for a broad discussion of corporate performance as measured by an array of performance measures in the CD&A, but I think a *relative to competitors* Total Shareholder Return *picture* will be a clearer, simpler and more transparent report card on overall management performance.

Performance Graph: Impact on Moderating Unwarranted Executive Compensation

When I first read the 1992 disclosure rule (Release No. 33-6962) that proposed requiring a relative TSR performance graph in the proxy within a couple of pages of the narrative justifying executive bonuses and equity grants, I predicted that the graph would have a significant impact on restraining the unwarranted growth of executive compensation at companies that trail their competitors in relative TSR.

I am sure glad no one asked me to 'fund' that prediction. During the past 14 years since the adoption of the 1992 amendment, there have been many egregious examples of oversized bonuses and/or and equity grants to executive officers of companies that woefully trailed their competitors in the Performance Graph.

Yet, I will say that I have been present at after year-end meetings of a client's senior management team celebrating their success at attaining their self-constructed performance targets and the only truly noxious odor in the room threatening to spoil the party emanated from the required performance graph illustrating how their market competitors continue to thump them in the only measure shareholders really care about.

As a consultant, the required inclusion of the Performance Graph a couple of pages after the executive compensation tables and narratives was an important weapon in helping to enforce a true pay for performance environment. I was not always able to moderate excessive compensation recommendations from management, but I was often able to redirect the performance focus of the *compensation committee* from inside the company (i.e., beating their own self-constructed performance targets) to outside the company (i.e., beating the performance targets of the competitive marketplace).

The primary reason executive compensation disclosure is so important is the inherent imbalance of market forces in setting executive pay. The Performance Graph is not a silver bullet to reestablish arms length balance, but I contend it is a valuable weapon and should be retained as a red letter "A" on the chests of all under performing management teams.

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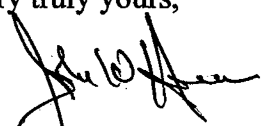
If you have any questions concerning these comments, you can reach me by phone at 972-931-2450 or by e-mail at famsinger1@aol.com.

Very truly yours,



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