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April 5, 2006

Nancy Morris
Secretary
US Securities and Exchange Commission
100 F Street, NE
Washington DC 20549-9303

Re: Executive Compensation Disclosure Proposed Rules – File S7-03-06

Dear Ms. Morris,

Please find enclosed our comments regarding the SEC's Executive Compensation Disclosure Proposal.

Our firm is leading consultancy advising boards and management in the alignment of organization design, CEO succession and executive pay for performance. Our research on organization structure / CEO accountability / talent management / executive pay and shareholder value is recognized worldwide. This research was referenced by 10 of the world's largest pension funds (with over $ 1 trillion in invested assets) in a recent letter to the SEC about the divide between executive pay and performance in too many U.S. listed companies. Many in the media have referenced our research including USAToday, The New York Times, Wall Street Journal, and CNBC. This research, including articles about strategic pay and pay for performance is also available at www.mvcinternational.com.

The SEC is to be congratulated for this initiative. Executive compensation provides a unique window into a board's effectiveness in discharging its fiduciary duties. Much of what has been proposed will significantly improve disclosure of executive compensation decisions and practices, allowing shareholders to make more effective investment decisions.

The SEC has received a number of excellent comments on the proposed compensation disclosure rules. We will focus our comments primarily on specific critical issues that have *not yet received substantial comment* and that we believe could materially affect the quality of executive compensation disclosures.

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These issues include:

- **Judging equitable and fair versus excessive executive compensation**
- **Differentiating strategic versus operational work and pay in disclosures for NEO roles**
- **The material process and control failures in current compensation benchmarking practices and subsequent misleading disclosures**
- **The material process and control failures in evaluating "internal pay equity" and subsequent misleading disclosures**
- **Easily accessible disclosure of the *total* structure and amount of executive compensation**
- **The need for a *filed* Compensation Committee report**

Judging equitable and fair versus excessive executive compensation

Shareholders cannot judge whether compensation is equitable and fair or excessive solely by reviewing disclosures about compensation. Compensation exists relative to the role, relative to other roles in the company, relative to other comparative roles across the industry, and relative to the performance of the enterprise over one, three, five years and longer.

Current pay equity legislation and related court precedents recognize that a legally defensible pay decision cannot be made unless there is a meaningful analysis of the work performed as a basis for determining job complexity, accountability and value relative to pay. We propose that the principles of this existing federal legislation and court precedents should also apply to executive pay and thus executive pay disclosures.

The appropriateness of executive compensation (base salary and incentive compensation) can only be judged by boards, compensation consultants, shareholders and other stakeholders if there is also a meaningful executive job analysis and disclosures related to:

- the executive work and level of job complexity and value (relative to roles inside the company and across its industry), including an analysis and disclosure of key performance metrics, longest performance periods, key accountabilities and key decision authorities;

- the actual performance achieved (measured by both intrinsic value and shareholder wealth) over both short-term (one year) and longer-term (at least three year) performance periods.

Today it is very difficult – and often impossible – to find disclosures about what NEO roles are being held accountable and paid for and the performance results achieved in relationship to compensation granted or earned. It can take hours of reading through 10Ks, proxy statements, annual reports and other company information just to uncover sketch tidbits regarding executive role accountabilities and performance.

Before Directors can address the question of "how much" compensation is fair and equitable, they must first address the questions "for what level of work" and "for what level of performance". Investors deserve disclosures on the same.

Differentiating strategic versus operational work and pay in disclosures for NEO roles.

Current disclosures indicate that too many Boards and their executive compensation consultants are confused about the difference between *operational* work, measurement and pay and *strategic* work, measurement and pay.

Operational work is focused on shorter-term (one to two year) performance periods related to running current business operations. While important, this is not the appropriate work of senior executives in most SEC-regulated companies. At the median of the Russell 3000 some 56% of enterprise market value is based on the expectation of future value to be created beyond existing business operations. This future value includes the expectation of growth, profit and return from yet-to-be-created *new* products, *new* markets, *new* business and *new* industries.

Executive management should be held accountable primarily for growth and innovation and the investment of capital in creating these new products, new markets, new businesses and new industries. This is the differential level of work that adds value for customers and shareholders and justifies significantly higher executive pay relative to more operational roles at lower and less complex job levels in the enterprise.

Shareholders need information on whether executive roles are being held accountable for strategic work for two reasons. First, if a company whose future value as a percent of market value is 30% or greater does not have metrics and performance periods that hold NEO roles accountable for, and does not pay them for achieving this expected future growth and innovation, then shareholders are at significant risk of financial loss. Over longer performance periods (5 years +), enterprise market value will fall to reflect the *true* intrinsic value and cash flow generation potential of the enterprise. The recent collapse in equity valuations from 2001 to 2003 is evidence of the disconnect between the path to profit and return on invested capital versus enterprise valuations and executive compensation program design.

The lack of disclosure today regarding the alignment between organization design, executive accountabilities, performance metrics, performance periods and executive compensation design puts shareholders at significant risk. The majority of U.S. listed companies currently have a market value more than 50 % of which is based on the creation of future value but no apparent alignment in executive accountabilities and pay design to attempt to create that value. In fact, fewer than 15 % of listed companies disclose whether executive management is held accountable and paid for creating the future value already built into enterprise valuation and stock price.

Second, if a company has four to six layers of management all primarily focused on running the current business operations, all with the same one to two year performance metrics related to current business operations, then it has poor organization design with some two to three layers of redundant management and wasted compensation adding no value for shareholders.

Disclosure of compensation plan metrics, performance periods and both intrinsic and shareholder wealth targets are critical to investors' ability to understand and evaluate what executives are being held accountable for. Shareholders also need disclosures that clarify what metrics are being used to align and trigger short-term incentive compensation versus longer-term incentive compensation. Too often companies are using the same operational performance metrics to trigger both short and longer-term incentives, effectively paying executives twice for the same operational work.

Without disclosures of both operational and strategic performance metrics shareholders have no basis from which to evaluate the alignment between the business strategy, executive accountabilities and executive compensation design. Disclosures should be required of the longest performance period NEO roles are held accountable for, and some type of innovation metric (new products, new markets, new businesses, new industries) to assist investors in evaluating the extent of alignment between a company's compensation plan, strategic plan, equity market valuation and shareholder risk. Today some leading companies such as Johnson & Johnson and 3M already disclose strategic performance metrics such as five year performance periods and innovation / growth metrics, and the alignment with executive accountability and compensation.

The material process and control failures in compensation benchmarking practices and subsequent misleading disclosures

Today's compensation benchmarking and survey practices are significantly flawed, leading to materially misleading disclosures.

First, in selecting peer companies for benchmarking, the standard compensation consulting practice of selecting companies whose revenues or assets are .5X to 2X the size of the target client automatically skews disclosed pay percentiles lower and creates an upward ratcheting effect on compensation. It also does *not* reflect the true market for executive talent - the market from which the company would recruit potential NEO replacements.

Let's use Hewlett Packard as an example. HP recently recruited a new CEO from NCR, a company whose revenue and asset size is .01 X or 1/10th that of HP and whose CEO Total Direct Compensation is 60 % less than that of HP. While HP chose to recruit a CEO from NCR, reflecting the real market for executive talent, they did not choose to include NCR as a peer company for compensation benchmarking. HP states in their current proxy that they target pay at the 50th pay percentile of their peer group, yet if they had included companies like NCR in their peer group calculation they would find and disclose that they may be actually be paying at the 80th + pay percentile of the true market for comparable executive talent.

Second, in selecting peer jobs for benchmarking, not all CEO roles are created equal. Yet current executive pay setting practices assume they are. As an example, although Eli Lilly and Johnson & Johnson operate in the same industry, the CEO role of Johnson & Johnson is, by our calculation, roughly 5 times more complex that the CEO role at Eli Lilly. This job complexity differential is based on recognized processes for executive job analysis and comparison, which take into account that CEO role complexity is affected less by company size, and more by the complexity of the number of businesses, sectors of businesses and countries in which an enterprise operates worldwide and the level of CEO accountability to create future value for shareholders.

Eli Lilly discloses that it includes Johnson & Johnson as a peer company for benchmarking compensation but discloses nothing about what process it uses to determine whether the compared roles are sufficiently similar to make comparisons meaningful. The 2006 Eli Lilly proxy discloses CEO cash compensation (base and bonus) of $ 3,832,020. The Johnson & Johnson 2006 proxy discloses CEO cash compensation (base and bonus) of $ 4,584,615, which might lead a shareholder or board member to believe that the Eli Lilly CEO is underpaid. However, given the differences in job complexity of the J&J CEO role relative to the Eli Lilly CEO role, an appropriately job matched and calibrated compensation amount for the J&J CEO to be used by the Eli Lilly board is approximately $ 1,793,708 -- not the face value number of $ 4,584,615. This adjusted number is more than 60 % lower than the face value cash compensation number disclosed in the J&J proxy. This material difference in the true comparable number should significantly affect any calculation in determining whether Eli Lilly is truly paying at the disclosed "broad middle of the range" of the comparative peer group of healthcare companies.

But the Eli Lilly proxy statement does not disclose whether there was any meaningful formal process for job matching and compensation calibration to reflect differences in executive job complexity in developing valid and reliable comparative compensation data. Directors will be unable to exercise good business judgment on comparative executive compensation without such a process.

The above examples of lack of defensible process and clear standards of practice are widespread throughout the compensation consulting industry, which unlike financial auditors, is neither a licensed nor a regulated profession. Given these material process failures in current compensation practices, the SEC should require issuers that choose to disclose the use of a peer group for compensation comparison to also explain in detail their processes and rationale for selecting peer group companies.

Such issuers should also be required to disclose the processes they are applying for defensible job matching (beyond just using job titles), the factors analyzed to assess the level of job complexity to test for job comparability and, where there were material differences in job complexity and accountability (i.e. CEO role to CEO role), the compensation calibration process used to provide the board with valid, reliable and truly comparative compensation information. It should also be noted that research has identified that revenue size of an enterprise is not a good proxy for correlating executive job complexity.

Given these material and widespread process failures, a boilerplate disclosure statement about Directors using "judgment and discretion" to make compensation decisions, should not be not be accepted by the SEC.

The material process and control failures in evaluating internal pay equity and subsequent misleading disclosures

Given the significant problems in the use of compensation surveys just detailed, some are suggesting that internal pay equity ratios be used as a key benchmark to assist directors in the executive pay setting process. While in principle this internal pay equity test should be given as much – if not more - weight than external surveys in the executive pay setting process, the calculation and rationale for the multipliers between the CEO other levels in the managerial hierarchy must again be clearly understood and disclosed if such information is not to be misleading to shareholders.

A key organizational principle is that only differential work can justify differential pay. In fact, numerous research studies have found that the "felt fair pay" multiplier for each level of differential work is two times. In other words, if I believe that you are doing a job one level above mine in role complexity, I think it is fair that you make twice what I make. But this type of ratio and multiplier is only meaningful if the work performed is truly different. If the top two to three levels of the enterprise all have the same metrics and performance periods, then in reality they are performing the same work -- *not* differential work. A disclosed 2 to 4 times + pay ratio between the CEO and direct reports when they are performing the very similar work is a misleading disclosure.

If an issuer discloses that it considers internal pay equity in their pay setting process, then it should also explain in detail the role it played in the pay setting process, the basis for determining differential work that justified differential pay, and the rationale for the pay ratio that was considered fair and equitable between levels in the managerial hierarchy.

Given the need for clarity regarding the nature of the work of executive management in determining fair and equitable compensation, and the need to compare roles on an " apples to apples" basis both within companies (internal pay equity) and between companies, we recommend that a meaningful job description be disclosed for all roles for which compensation is disclosed.

This job description would not be a laundry list of job duties, but a specific, short, role profile that clearly outlines specific performance metrics, performance periods, and key decision authorities delegated by the board. Ideally the disclosures would include the complete hierarchy of governance measurement for NEO roles. This includes operational measures, strategic measures and triple bottom line (TBL) measures. By mandating this hierarchy of measurement into disclosures, including TBL metrics, then investors can see to what extent NEO's are held accountable and paid to consider the broader and longer-term societal, environmental and ethical issues that could impact long-term enterprise value and stock price. The CD&A should disclose why the specific metrics and performance periods were chosen by Directors.

The disclosure of such a job profile document would provide evidence to shareholders that the board has thoughtfully deliberated to define the work of executive management, aligning that work to the business strategy, and in determining appropriate pay for those roles. Detailed forward-looking disclosure of compensation plan performance criteria is required in the UK, Australia and the Netherlands. These disclosures have not compromised companies' competitive positions and have resulted in both better understanding and higher quality dialogue between investors and companies about compensation and pay for performance issues.

Easily accessible disclosure of the *total* structure and amount of executive compensation

The Compensation Discussion and Analysis section should disclose that the Board is fully informed on all the elements and total costs of the compensation program it has reviewed and approved. The Board should be required to disclose whether it has reviewed a tally sheet of ALL compensation reflecting the total program costs and the impact of those compensation costs on both the income statement and balance sheet over multiple years. The CD&A should be required to contain disclosure that the compensation committee believes the total compensation plan and realized compensation is “fair, reasonable and not excessive” relative to the work and accountabilities of the Named Executive Officers, and relative to the performance of the company over one year and three year plus performance periods, and the process, rational and facts on which that opinion is based.

The CD&A should also require disclosure regarding the percentage of total compensation that is service or time-based versus the percentage that is based on the business performance of the company.

To eliminate confusion, we believe that two distinct tables are necessary: a realized compensation table and a future compensation opportunity table. The realized compensation table should cover at least the last three years and ideally the last five years of actual realized compensation so shareholders can better understand the cumulative wealth effect for NEO’s.

The factors to be included in these tables would include:

Realized Compensation: received in the fiscal year (3 to 5 years of historical data) to most current year)	**Future Compensation Opportunity: Target Granted**
Base Salary	Base Salary rate (rate set for the year to come, including merit increase)
Cost of all perquisites and other benefits received (itemized in additional table)	Expected future costs of perquisites and benefits to be received in the future (itemized in an additional table)
Annual Bonus	Target Annual Bonus
Key performance metrics considered that triggered annual bonus payout, if any	Performance metrics linked to current operating business plan and annual bonus
Value of time-based restricted stock that vested	Value of unvested time-based restricted stock, amortized over the vesting period
Value of performance-based restricted stock that vested	Value of unvested performance-based restricted stock, amortized over the vesting period
Value of any exercised stock options	Grant date value of stock options
Value of any other LTIP payout	Target payout of any other LTIP
The performance metrics and performance period to which performance based restricted stock or stock options that were realized were tied	The performance metrics and performance period to which future performance based restricted stock or stock options are tied.
All other material compensation including (itemized in additional table)	Expected cost of all other compensation (itemized in additional table) including Pensions, SERPS and any deferred compensation
Total Compensation	Total Future Target Compensation

The need for a *filed* Compensation Committee report

The board exercises or fails to exercise its fiduciary duty in setting performance metrics and performance periods, in evaluating the performance of management, and in structuring the compensation of executive management for achieving both operational and strategic goals. One of the few ways shareholders have to determine whether Directors are fulfilling their fiduciary duty is in the disclosure of performance metrics and performance periods to which base salary, bonus and long-term compensation are tied.

As the legal fiduciary for shareholders in making these performance setting, evaluation and pay decisions, the compensation committee should sign the compensation report. Given the significant process failures that exist today and that have led to materially misleading disclosures, the CD&A should be a filed document. Indeed, we find it hard to understand why it should *not* be filed. Compensation decisions are critical to the future risk and performance of a company; shareholders deserve to have as much faith in the reliability of these disclosures and their supporting processes as they do in other mandated disclosures.

We hope the enclosed adds value to the comments already received, and provides clarity as to why further guidance to issuers and specific further disclosures are required by the SEC in fulfilling its mandate for the investing public. Please feel free to contact me with further questions.

Yours sincerely

Mark Van Clieaf
Managing Director