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Capital Markets and Securities

A bulletin prepared by the Capital Markets Group at Vedder Price designed to keep corporate executives and investment banking professionals informed of major developments in the securities industry.

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EXECUTIVE COMPENSATION IN THE 2005 DISCLOSURE SEASON AND BEYOND

The Sarbanes-Oxley Act of 2002 has significantly changed the environment in which public companies operate. Part of this shifting landscape includes the SEC's intensified interest in reviewing public company disclosures in the executive compensation arena. The SEC's interest in this area has been evidenced by recent enforcement actions against The Walt Disney Company and General Electric Company, an investigation of Tyson Foods, Inc. and noteworthy comments by the Director of the SEC's Division of Corporation Finance. These developments highlight the importance to public companies of developing and maintaining sound practices and processes to ensure full compliance with the SEC's executive compensation disclosure requirements.

To help our clients and friends during the 2005 disclosure season, we have summarized current trends in executive compensation disclosure, including certain topics of concern for the SEC.

Current Trends in Executive Compensation Disclosure

Compensation Committee Reports

Now is the time for clear disclosure of compensation matters that help an investor understand what is going on.[1] Recent commentary has identified a tendency of companies to provide boilerplate disclosure that merely strives for "literal compliance" with the rules. Such commentary has also noted that Item 402 of Regulation S-K states generally that all compensation must be disclosed. As a result, many companies will be taking a closer look at their compensation committee report and proxy statement disclosures. This closer look should include the following questions:

- Does the report provide "clear, concise and understandable disclosure of all plan and non-plan compensation awarded to, earned by, or paid to the named executive

[1] "The compensation committee is responsible for ensuring that all aspects of executive compensation are clearly, comprehensively and promptly disclosed, in plain English, in the annual proxy statement regardless of whether such disclosure is required by current rules and regulations. The compensation committee should disclose all information necessary for shareowners to understand how and how much executives are paid and how such pay fits within the overall pay structure of the company. It should provide annual proxy statement disclosure of the committee's compensation decisions with respect to salary, short-term incentive compensation, long-term incentive compensation and all other aspects of executive compensation, including the relative weights assigned to each component of total compensation." *Remarks before Conference of the NASPP, the Corporate Counsel and the Corporate Executive by Alan L. Beller, Director, Division of Corporation Finance, Securities and Exchange Commission (October 20, 2004).*

officers…and directors…for all services rendered in all capacities to the registrant and its subsidiaries…"?

- Does the report explain why and how the company's compensation committee decided on the compensation that it awarded to named executive officers in the past year?

- Does the report disclose the nature of the group with which the compensation committee is comparing the company's compensation, the basis of selection of the group, the extent to which it differs from the benchmark group, and where in the range established by that comparison the company targets its compensation?

- If the amount or form of compensation awarded to named executive officers changed materially or significantly from the prior year, does the report explain what caused this change?

- Does the report detail the company's position regarding qualification of compensation for exemption from the deduction limits of Section 162(m) of the Internal Revenue Code?

- Does the report describe any executive stock ownership guidelines?

- Does the report describe any imposed holding period on stock Named Executive Officers and/or other executives receive from the company?

Best Practices

At this point, 2004 is in the books. But it is not too early to lay the foundation for next year's report. As noted above, good meeting practices set the stage.

SEC current rules require disclosure in the compensation committee report of (1) executive compensation policies, (2) the specific relationship of corporate performance to executive compensation, (3) the factors on which the CEO's compensation is based and (4) a specific discussion of the relationship of the company's performance to CEO compensation, including a description of each measure of company performance on which CEO compensation is based.

In fulfilling these obligations, we suggest that companies consider the following actions during 2005:

- Review and update, if necessary, D&O questionnaires to ensure that all executive compensation and related-party transaction information is obtained.

- Review the company's disclosure controls and procedures to ensure whether they are adequate to enable the compensation committee to account for all compensation received by the executive officers and directors.

- Develop a "compensation philosophy" aimed at establishing a linkage between company and individual performance and fair, competitive executive compensation, reflecting both upside potential and downside risk.[2]

[2] A compensation philosophy should articulate the compensation committee's fundamental principles and guide the compensation committee in developing and monitoring the company's executive compensation programs. These principles should reflect (1) independence of committee members, (2) pay packages that are perceived as fair both internally and externally, (3) payments that are linked to realistic and achievable performance criteria, (4) incentives toward long-term shareholder value creation, and (5) full transparency regarding compensation plan design and implementation.

- Understand the maximum payout under multiple scenarios, including retirement, termination with or without cause, and severance in connection with a change in control of the company.

- Prepare and review a “tally sheet” that sets forth all components of the CEO’s compensation, including base salary, bonus, long-term incentives, realized and unrealized stock option and restricted stock gains, dollar value of perks and other personal benefits and the cost to the company, earnings and accumulated payment obligations under the company’s nonqualified deferred compensation programs and projected payment obligations under the company’s supplemental executive retirement plan.

- Adopt a committee calendar for the full year[3] and, if possible, have the compensation committee consider items twice—once for preliminary review and again for finalization and approval.

[3] For your convenience, a model committee calendar is attached as an appendix to this newsletter.

APPENDIX A

[NAME OF COMPANY]

ANNUAL SCHEDULE OF THE COMPENSATION COMMITTEE

Depending on its financial position, competitive situation and other factors, each compensation committee will have different priorities. However, we believe that the following schedule is a good starting point for focusing the committee on its annual responsibilities and objectives.

First Quarter

- Review and finalize approval of awards under incentive arrangements, contributions to retirement plans and management's recommendations regarding raises for executive officers.
- Set and approve financial measures and performance goals for incentive arrangements for the new year.
- Review the compensation of the board of directors and executive officers.
- Prepare compensation committee report for proxy statement.

Second Quarter

- Review areas of concern to attract and retain staff.
- Review the progress and development of executive officers during the year.

Third Quarter

- Perform strategic review of compensation plans.
- Assess the ongoing competitiveness of the total executive compensation pay package.

Fourth Quarter

- Recommend to the board of directors the annual salary level and short- and long-term incentive arrangements for the CEO.

Initial review and consideration of awards under incentive arrangements, contributions to retirement plans and management's recommendations regarding raises for executive officers.

Capital Markets and Securities bulletin is published by the law firm of Vedder, Price, Kaufman & Kammholz, P.C. It is intended to keep our clients and other interested parties informed of developments in corporate finance and securities matters. It is not a substitute for professional advice.

If you have any questions regarding material in this issue of *Capital Markets and Securities*, or suggestions for a specific topic you would like addressed in a future issue, please contact any member of the Capital Markets Group.

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Vedder, Price, Kaufman & Kammholz, P.C. is a national, full-service law firm with more than 210 attorneys in Chicago, New York City and Roseland, New Jersey. The attorneys in the firm's Capital Markets Group regularly represent corporations and investment bankers, both foreign and domestic, in a wide variety of matters, including:

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