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Executive Compensation 2008

Executive compensation will continue to attract significant interest in 2008. In light of this attention, this memorandum describes some key recommendations for directors to consider as they address executive compensation matters in the coming year.

Focus on the Long-Haul. As activist shareholders continue to emphasize short-term gains at the expense of long-term value creation, companies should design compensation arrangements that motivate management to focus on long-range objectives. Multi-year performance and vesting periods, reasonable share ownership requirements and dividend reinvestment features will help promote this goal.

Pay for Performance *and* Retention. Attracting and retaining key employees in a competitive marketplace is essential to the success of any business enterprise. Given the recent difficulties in the financial markets and the economy generally, pre-established performance goals may yield low or no bonuses. Similarly, given recent market volatility, employees of many companies may hold a substantial number of underwater options and other equity awards with significantly lower value than the grant date target value. In light of these challenging conditions, compensation committees will need to weigh pay for performance principles against the need to attract and retain employees. Informed directors are aware that human capital is a prized asset and should structure compensation practices accordingly.

Succession Planning. 2007 has demonstrated that planning for succession of the CEO and other senior executives is critical for the long-term success and stability of any public corporation. Careful succession planning is also an excellent way to meet compensation challenges, as studies indicate that it is considerably more expensive to recruit senior talent from outside an organization than from inside, and pay packages for outside recruits are often more publicized and scrutinized than compensation arrangements for internal candidates. Succession planning should be a top priority of the board and CEO, and the board should evaluate annually the status of future generations of company leadership.

Wealth Accumulation and Internal Pay Equity. Analytic tools, such as wealth accumulation analyses and internal pay equity studies, are the latest trend among executive compensation advisors. While these tools may have attracted significant attention in the last year, they do not necessarily provide sound bases for making compensation-related decisions. There is no evidence that either curtailing an executive's future earnings because of past earnings or setting CEO pay as a ratio to the pay of other employees will enhance firm performance or retention.

Compensation Consultants. Recently, the House Committee on Oversight and Government Reform sent letters to 250 of America's largest public companies requesting information on the nature of services that compensation consultants provide to the companies. In light of this development and as a matter of good corporate governance, compensation committees should understand the nature and scope of services that consulting firms and their affiliates provide to the company in order to evaluate any actual or perceived conflicts of interests.

Disclosure and Analysis. Executive compensation disclosure will continue to attract significant attention in 2008. The Compensation Discussion and Analysis in company proxy statements should describe the compensation committee's rationale for providing each compensation element to each named executive officer. While some commentators have criticized as insufficient statements that a particular element of compensation is designed to offer a competitive compensation program, we believe that a competitiveness rationale should satisfy applicable disclosure requirements if it accurately describes the committee's reasoning. More generally, the fact that critics do not agree with a compensation practice or philosophy does not make the disclosure regarding that practice or philosophy insufficient and companies should not prepare disclosure merely to appease critics. As we enter the coming proxy season, directors should consult with company counsel to ensure that they are responsive to the SEC Staff's most recent guidance regarding executive compensation disclosures and any disclosure commitments made by the company to the SEC Staff in connection with the SEC Staff's 2007 review.

Disclosure and Performance Targets. Pressure from shareholder activists to disclose performance targets under compensation arrangements continues. We believe that disclosure of confidential targets is harmful to American business and may shift performance goals away from meaningful business metrics that align executive and shareholder interests. A company must disclose performance metrics only if disclosure is necessary to an understanding of the material terms of the compensation program and only if disclosure would not result in competitive harm. The standard for excluding disclosure of performance targets based on competitive harm is high. Management should document and discuss with the compensation committee its rationale for withholding performance targets. Moreover, if a company does not disclose its targets, it must describe the degree of difficulty of achieving them (e.g., by reference to historical levels of achievement). A company that is currently in discussions with the SEC Staff about this issue should seek resolution in advance of filing its 2008 annual meeting proxy statement and prior to establishing bonus targets for 2008.

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