Committee on Securities Law
of the Business Law Section of the
Maryland State Bar Association

September 14, 2009

<u>Via email to rule-comments@sec.gov</u>
Elizabeth M. Murphy
Secretary
U.S. Securities & Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

RE: <u>File No. S7-13-09</u>

Dear Secretary Murphy:

This letter expresses to the Securities and Exchange Commission (the "Commission") the comments of the Committee on Securities Law of the Business Law Section of the Maryland State Bar Association (the "Committee") with respect to the rules proposed in Release No. 33-9052, 74 Fed. Reg. 35076 (July 17, 2009) (sometimes referred to herein as the "proposing release"), relating to proposed amendments to the Commission's compensation and corporate governance and proxy solicitation rules.

In general, we support the Commission's proposed revisions. However, we have comments on the following matters detailed below.

I. Enhanced Compensation Disclosure

A. Compensation Discussion and Analysis ("CD&A") Disclosure

We generally agree with the Commission's proposal to amend the CD&A requirements to include a new section providing information about how a company's overall compensation policies create incentives that can affect the company's risk and management of that risk. According to the proposing release, "[t]he proposed amendments would require a company to discuss and analyze its broader compensation policies and overall actual compensation practices for employees generally … if risks arising from those compensation policies or practices may have a material effect on the company."

The Commission asks in the proposing release whether smaller reporting companies, or SRCs, despite the fact that they are not required to provide CD&A disclosure, should be required to provide disclosure about their overall compensation policies as they relate to risk management. As discussed below, we do not believe that adoption of the proposal would result in meaningful new disclosures to investors. Moreover, by their nature most SRCs have straightforward compensation structures that do not implicate complex risk management issues.

Finally, adoption of the proposal would further unnecessarily strain the limited management and reporting resources of smaller reporting companies.

In our view, smaller reporting companies and their compensation structures generally are not geared towards the kind of disclosure that would be required by this portion of the proposal. Smaller reporting companies typically have straightforward compensation structures consisting of a base salary, annual bonus, and basic equity grants that generally vest over a period of a few years. Given their modest equity float, SRCs are restrained in making truly outsized equity grants, and smaller reporting companies' compensation plans generally do not provide for complex performance metrics that contribute to inappropriate risk-taking. Further, the compensation paid to executives of SRCs has not generally been the target of recent stockholder and public ire regarding executive compensation, and smaller reporting companies are generally not as likely to be taking the types of risks that have resulted in the implosion of some larger companies. Similarly, the risks that smaller reporting companies do take are unlikely to adversely affect other companies and the economy as a whole in the manner that we have seen in this latest economic crisis.

In addition, we believe it is anomalous to ask smaller reporting companies to include this portion of the CD&A disclosure when they are not subject to CD&A disclosure generally. First, we think it would be confusing for investors if smaller reporting companies include only a risk discussion and not the analysis of compensation decisions and principles required by CD&A. Second, we believe that the proposed risk disclosures would require SRCs to provide a CD&A-like explanation of compensation structures to put the risk discussion in context. This type of "back door" disclosure requirement is inappropriate. The Commission's proposing release with respect to the 2006 revisions to the Commission's executive compensation disclosure requirements in this regard "recognize[d] that the executive compensation arrangements of small business issuers[1] typically are less complex than those of other public companies … [and] that satisfying disclosure requirements designed to capture more complicated compensation arrangements may impose new, unwarranted burdens on small business issuers." This same reasoning also counsels against the imposition of risk-based compensation disclosures on SRCs.

B. Revisions to the Summary Compensation Table/Director Compensation Table

1) Grant Date Fair Value Reporting

We strongly support the Commission's proposal to revise the Summary Compensation Table and Director Compensation Table to include the reporting of stock and option awards based on the aggregate grant date fair value of those awards in accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ("FAS 123R") instead of the current method of disclosing the dollar amount recognized for financial statement reporting purposes with respect to the fiscal year in accordance with FAS 123R. We believe that grant date fair value reporting provides a

[1] The "small business issuer" category was later replaced with the current "smaller reporting company" category for smaller issuers.

more accurate picture of the true compensation the named executive officers were awarded in the applicable fiscal year because it reflects compensation decisions that were actually made in or with respect to the fiscal year, whereas under the current method the results of compensation decisions made perhaps several years before are reflected in current compensation. Thus, a large equity grant made in a particularly profitable year or to reward an executive for outstanding performance in a particular year can, if the award vests over several years, result in disclosure of significant compensation amounts in subsequent years when company performance may have significantly declined. This would cause disclosed compensation to appear inappropriately large in subsequent years. At the same time, disclosure under the current method in these circumstances would distort downward the compensation awarded for the year with respect to which the award was granted.

2) Time of Disclosure of Stock and Option Awards

The proposing release contemplates that the Summary Compensation Table would report the aggregate grant date fair value of equity awards granted during the relevant fiscal year. The Commission asks, however, if instead the Summary Compensation Table should report the aggregate grant date fair value of equity awards granted for services in the relevant fiscal year, even if the awards were granted after the end of the fiscal year. We believe that the latter method is preferable – i.e., that the value of equity awards should be disclosed for the year in which the services generating the award were performed, even if the awards are actually granted in a later year. First, disclosure in this manner would be consistent with the current reporting of other types of compensation in the Summary Compensation Table, which are reported in the year earned. In particular, we note that awards under non-equity incentive plans are reported in the Summary Compensation Table for the fiscal year in which the services pursuant to which the award is granted are performed, even if the award is payable at a later date.[2] Similarly, bonuses, even though usually not determined and paid until after year-end, are required to be reported as compensation in the year earned regardless of when the bonus is paid.[3] We believe that it would be confusing for some types of executive compensation (including salary, bonuses and non-equity incentive plan compensation) that are awarded for services provided in one year to be disclosed in the table as compensation for that year while other types of compensation - stock and option awards – awarded for services provided in the same year are disclosed as compensation in a subsequent year. For example, under the current proposal if a company's compensation committee in January 2010 determined to grant a named executive officer both a cash bonus and an option award based on 2009 performance, the bonus would be disclosed as 2009 compensation in the proxy statement for the 2010 annual stockholder meeting while the option award would be disclosed as 2010 compensation in the following year's proxy statement. We believe this result is anomalous and confusing. Under Item 402 of Regulation S-K, cash compensation is consistently disclosed as compensation in the year for which the relevant services were provided regardless of whether such compensation is awarded under an incentive plan. We see no reason why equity compensation should be disclosed differently than cash compensation.

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[2] Item 402(c)(2)(vii) of Regulation S-K and Instruction 1 thereto.
[3] Item 402(c)(2)(iv) of Regulation S-K.

Further, we believe that disclosing equity awards as compensation in the service year more accurately reflects the company's board or compensation committee's decisions with respect to named executive officer compensation. In other words, if the board or committee determined to grant awards based on 2009 performance, we believe that stockholders would expect to see those awards reflected in the Summary Compensation Table for 2009. Under the proposed method, stockholders generally might not be informed of the grant until the proxy statement with respect to the company's 2011 annual meeting – generally two years after the grant was made. In addition, this disclosure method would better track the corresponding CD&A discussion, which generally would focus on compensation decisions based on performance during the prior fiscal year.

Finally, as with the disclosure of stock and option awards based on the amount recognized in the relevant fiscal year, we believe that disclosing equity awards in the year in which they are granted, if granted with respect to services in the prior fiscal year, can present a distorted overall compensation picture. For example, if a named executive officer was awarded a particularly large grant of stock or options for accomplishment of a particular goal or overall extraordinary performance in a particular year, we believe that stockholders would expect to see that award reflected, and discussed, with respect to that particular year and not the following year. In addition, when looking at the overall disclosure in the summary compensation table, the inclusion of the large grant in the following year would increase the total compensation figure for the year following the one in which the goal or extraordinary performance was achieved, but have no impact on the compensation disclosure for the year in which the goal or performance was accomplished. As a result, the compensation disclosed in the table would not reflect the board or committee's compensation determinations with respect to the applicable year and could distort the overall compensation picture by making the compensation in what might be an ordinary or even bad year appear to be excessive and the compensation in the good year appear just average. In a case where a grant is made for services in a particularly good year that is followed by a bad year, stockholders reviewing the overall compensation disclosure in the Summary Compensation Table are likely to justifiably ask why a named executive officer received a large stock or option grant in a year that was so bad for the company and the stockholders. While this would of course be addressed in the CD&A, there seems to be little purpose for introducing this confusion in the first place. Further, for smaller reporting companies that do not provide a CD&A, the reason for the apparent discrepancy may be left unaddressed.

II. Enhanced Compensation Disclosure

A. Disclosure of Directorships

The Commission proposes to require disclosure of any directorships held by each director and nominee at any time during the past five years at public companies. Presently only current directorships need be disclosed.[4] The Commission has asked in this regard whether there are any additional changes it could make to further improve disclosures about director and director nominee qualifications. In this regard, we suggest that the Commission consider expanding this

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[4] Item 401(e)(2) of Regulation S-K.

disclosure to directorships at private companies. While some of the experience and knowledge that a director or nominee would gain serving on the board of a private company, such as accounting requirements that are applicable solely to private companies, may not be directly relevant to a director or nominee's qualifications to serve on a public company board, the general corporate governance experience and business and industry knowledge are relevant to a director or nominee's qualifications to serve on a public company board. This is especially true if, is as often the case for smaller reporting companies, a director nominee has no public company board experience.

We appreciate the Commission's consideration of the foregoing comments.

Very truly yours,

Committee on Securities Law of the Business Law Section
of the Maryland State Bar Association

By: /s/ D. Scott Freed
D. Scott Freed, Chair

By: /s/ Penny Somer-Greif
Penny Somer-Greif, Vice-Chair