

PULSE Study

Readability of CD&As Filed Under the New Proxy Disclosure Rules

April 9, 2007

Christopher Cox, Chairman of the U.S. Securities and Exchange Commission (SEC) shared the SEC's preliminary readability analysis of Compensation Discussion and Analysis (CD&A) sections filed in accordance with the new proxy disclosure rules in a March 23, 2007 speech¹. Chairman Cox criticized the readability of the forty (40) CD&As analyzed.

How did the SEC analyze readability? An outside communications firm analyzed the proxy disclosures of those forty companies. The results were not what Chairman Cox had in mind. The Chairman cited new readability statistics that were employed in this analysis: the Gunning-Fog Index, the Flesch Reading Ease Test, and the Flesch-Kincaid readability algorithm.

This marked the first time in the decade since the SEC began pursuing a plain English disclosure standard that it mentioned any statistical measure(s) that should or could be used in analyzing disclosures. Chairman Cox also warned that the SEC "may soon be looking to the Gunning-Fog and Flesch-Kincaid models to judge the level of compliance with the plain English rules."

According to Chairman Cox, the CD&As had a median length over 1,000 words longer than the U.S. Constitution, an average Fog Index of 16.45 (about the same as a Ph.D. dissertation) and an average Flesch Reading Ease score of 34.86 (about the same score earned by articles in the Harvard Law Review).

Given this, we thought it would be interesting to conduct a quick study of the readability of the CD&As of some representative large, mid, and small cap companies. We thought it also might be interesting to analyze the readability of some other documents. Therefore we analyzed the readability of Warren Buffet's 2007 Letter to Shareholders (overall, the readability appears to be at the level expected by the SEC Chairman, but it was by far the longest document analyzed), The Declaration of Independence, the U.S. Constitution (both with and without its Amendments) and Dr. Seuss' Green Eggs and Ham to get some sense of how these scores work.

As Chairman Cox has been critical of the understandability of CD&As filed to date, we, like many registrants and their advisors, have had similar thoughts regarding the language included in the proxy rules themselves. Out of curiosity, we analyzed the readability of the proxy rules (specifically Item 402) to see how they scored. While we certainly understand that these rules were not written for the average reader, it is no surprise that the readability scores of the rules are the worst of all the documents we analyzed. Based on the target scores mentioned by Chairman Cox, work needs to be done to improve the readability of CD&As *and* the proxy rules. What was the best score of any document analyzed? Dr. Seuss's Green Eggs and Ham easily passes Chairman Cox's readability standard. As an additional comparison point, we analyzed this document itself and determined that it falls far short of the readability standard (a Fog Index of 16.4 and a Flesch Reading Ease score of 50.5). If Chairman Cox truly intends to use the readability scores to test compliance with the plain English requirements, we suggest that his target scores also need to be reconsidered.

A note about methodology:

We do not suggest that our methodology for this quick study was completely and scientifically accurate or acceptable. However, we believe our methodology was reasonable and applied consistently to all documents analyzed. If you care to analyze your own disclosures, you can use a similar methodology and/or use the built-in readability analysis tools in Microsoft Word.

¹ Speech by SEC Chairman: Closing Remarks to the Second Annual Corporate Governance Summit, March 23, 2007, available at <http://www.sec.gov/news/speech/2007/spch032307cc.htm>

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Company	Mkt. Cap. (\$ B) 4/9/2007	GICS Sector	Readability Measures							# Words
			Kincaid	ARI	Coleman- Liau	Flesch Index	Fog Index	Lix	SMOG- Grading	
A higher number is...			Worse	Worse	Worse	Better	Worse	Worse	Worse	Worse
Mentioned by SEC Chairman Cox "Target" for Readability Score			●			●	●			●
						60 to 70	< 12			

The Readability of Other Documents for Comparison

	Green Eggs and Ham, Dr. Seuss			-1.3	-4.3	1.9	114.9	2.7	6.9	4.2	811
	Berkshire Hathaway Inc. - Warren Buffett's 2007 Letter to Shareholders			8.6	9.4	11.7	64.9	11.8	41.9	10.9	14,119
	The Declaration of Independence			12.5	14.8	14.0	49.2	15.9	52.2	13.6	1,508
	U.S. Constitution			13.9	16.6	12.2	51.1	16.7	54.0	13.0	4,657
	U.S. Constitution with Amendments			12.3	14.2	12.2	54.1	15.3	50.7	12.6	8,439
	Item 402 Proxy Rules and Instructions (without charts)			19.8	22.6	13.9	25.4	24.1	71.9	18.5	10,068
Large Cap	Altria Group, Inc.	147.67	Consumer Staples	14.7	16.4	15.1	36.7	18.4	57.7	15.5	5,293
	American International Group, Inc.	174.87	Financials	13.8	15.7	15.2	40.5	17.5	56.1	14.9	5,293
	Bank of America Corp.	226.07	Financials	13.8	15.5	15.9	37.8	17.7	56.4	15.1	4,070
	Berkshire Hathaway Inc.	167.78	Financials	12.5	13.6	14.0	45.1	15.6	54.6	13.6	514
	Citigroup Inc.	254.82	Financials	14.8	16.8	16.6	32.7	19.2	60.5	16.1	3,593
	General Electric	358.37	Industrials	14.3	15.9	14.8	38.7	18.2	57.2	15.4	6,051
	Johnson & Johnson	177.81	Health Care	15.1	17.2	15.1	36.6	18.9	60.5	15.8	6,312
	Pfizer, Inc.	183.33	Health Care	15.8	18.3	15.3	35.0	19.0	62.0	15.6	6,871
	Average	211.34			14.4	16.2	15.3	37.9	18.1	58.1	15.3
Median	180.57			14.5	16.2	15.2	37.3	18.3	57.5	15.5	5,672
Mid Cap	C.H. Robinson Worldwide	8.49	Industrials	13.6	15.4	15.9	38.6	17.1	56.9	14.7	4,367
	Developers Diversified Realty Corp.	7.99	Financials	17.1	19.6	14.6	31.7	20.7	65.2	16.6	6,952
	ENSCO International	8.31	Energy	17.7	20.5	15.7	27.5	22.0	66.8	17.7	5,350
	Expeditors International	9.20	Industrials	15.8	18.0	15.6	32.7	19.8	64.1	16.4	3,312
	MEMC Electrical Materials	13.76	Information Technology	16.6	19.2	14.6	34.2	20.3	63.7	16.3	2,617
	Noble Energy, Inc.	10.54	Energy	16.8	19.6	16.0	29.8	20.7	66.4	16.9	5,072
	Average	9.72			16.3	18.7	15.4	32.4	20.1	63.9	16.4
Median	8.85			16.7	19.4	15.7	32.2	20.5	64.7	16.5	4,720
Small Cap	Cimarex Energy Corp.	3.12	Energy	13.3	14.8	14.2	43.3	17.5	55.0	14.9	5,558
	Energen Corp.	3.86	Utilities	16.5	18.7	15.2	31.4	20.5	63.8	16.7	4,889
	Essex Property Trust	3.14	Financials	16.6	18.9	15.7	29.8	21.0	63.3	17.2	2,905
	Frontier Oil	3.68	Energy	14.5	16.2	15.1	36.5	18.2	58.9	15.4	5,806
	The Manitowoc Company	4.05	Industrials	14.2	15.7	15.5	36.4	17.9	57.2	15.2	3,871
	NVR, Inc.	4.04	Consumer Discretionary	15.0	17.2	14.1	40.1	18.3	57.6	15.0	4,864
	Southern Union	3.70	Utilities	14.2	16.2	17.3	33.2	18.2	61.2	15.4	3,648
	Average	3.66			14.9	16.8	15.3	35.8	18.8	59.6	15.7
Median	3.70			14.5	16.2	15.2	36.4	18.2	58.9	15.4	4,864

Methodology

In conducting this PULSE Study, we reviewed the Top 10 companies in the S&P 500, S&P MidCap 400 and S&P SmallCap 600 indices (shown below) to determine which had filed a proxy with a CD&A. For those companies that had filed a proxy with a CD&A, we then copied the CD&A text and pasted it into a Microsoft Word document, deleting page numbers and page breaks and adding a line at the top of the document identifying the company and the date the proxy was filed. We then went to Readability.info (www.readability.info) and uploaded each company's CD&A document and had the web site run a readability analysis on the CD&As. We also used Readability.info to test the readability of the comparison documents we referenced, including the rules themselves (without the required tables), the U.S. Constitution, the Declaration of Independence, Dr. Seuss's Green Eggs and Ham and Warren Buffett's Letter to Shareholders from 2007.

Large Cap Companies – Top 10 S&P 500 Companies – Source: S&P 500 Fact Sheet, 12/31/2006

- Altria Group, Inc.
- American International Group
- Bank of America Corp.
- Citigroup Inc.
- Exxon Mobil Corp. (last proxy filed 5/19/2006)
- General Electric
- Johnson & Johnson
- Microsoft Corp. (last proxy filed 10/12/2006)
- Pfizer, Inc.
- Procter & Gamble (last proxy filed 8/29/2006)

Berkshire Hathaway Inc. – added for comparison purposes to Large Cap group; not a Top 10 S&P 500 company

Mid Cap Companies – Top 10 S&P MidCap 400 Companies – Source: S&P MidCap 400 Fact Sheet, 12/31/2006

- C.H. Robinson Worldwide
- Developers Diversified Realty
- ENSCO International
- Expeditors International
- Lam Research (last proxy filed 10/10/2006)
- MEMC Electrical Materials
- Microchip Technology (last proxy filed 6/30/2006)
- Noble Energy, Inc.
- Precision Castparts (last proxy filed 7/3/2006)
- Sepracor Inc. (last proxy filed 4/14/2006)

Small Cap Companies – Top 10 S&P SmallCap 600 Companies – Source: S&P SmallCap 600 Fact Sheet, 12/31/2006

- Cerner Corp. (last proxy filed 4/20/2006)
- Cimarex Energy Corp.
- Energen Corp.
- Essex Property Trust
- Frontier Oil
- Global Payments Inc. (last proxy filed 8/31/2006)
- Manitowoc Co.
- NVR, Inc.
- Southern Union
- Veritas DGC (n/k/a CGGVeritas Services, Inc.) – non-U.S. listed company



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