



FENWICK & WEST LLP

Corporate and Securities Law Update

SEC Proposes New Rules for Executive Compensation Disclosure

JANUARY 18, 2006

At its open meeting yesterday, January 17, 2006, the Securities and Exchange Commission approved for comment sweeping new rule proposals that would dramatically alter many public company disclosure practices. The proposed rules would affect disclosure in proxy statements, annual reports and registration statements, and require disclosure in plain English. Most of the proposals are in the area of executive and director compensation disclosure mandates. In addition, the proposals would amend disclosure requirements about related party transactions, director independence, corporate governance, and security ownership of officers and directors. The proposed rules would also modify current Form 8-K reporting requirements for employment arrangements. All five commissioners expressed their support for this effort to improve compensation disclosure, which was last overhauled 14 years ago, and welcomed comments on the proposals.

Executive and Director Compensation

The proposed rules would require a new section, known as “Compensation Discussion and Analysis,” consisting of a narrative and several tables. The Commission’s objective is to elicit clearer and more complete disclosure about compensation for the principal executive officer, the principal financial officer and the three other highest paid executive officers and the directors. The current Compensation Committee Report and stock performance graph would be eliminated. CEO and CFO certifications would apply to all the new disclosures.

Under Compensation Discussion and Analysis the company would describe its executive compensation program objectives, the elements of the compensation program, and why those elements were selected. Following this section, executive compensation disclosure would be organized into three categories: compensation over the last three fiscal years; holdings of equity-related interests received as compensation that are the source of future gains; and retirement plans and other post-employment payments and benefits. Director compensation would also be summarized in a table and related narrative.

1. Compensation Over the Last Three Years

The current Summary Compensation Table would be reorganized:

- A new column would report total compensation for each individual – a single bottom-line figure that aggregates all compensation for the year.
- The dollar value of all stock-based awards, such as restricted stock and stock options, measured at grant date fair value (based on FAS 123R) would be shown.
- The “All Other Compensation” column would include the aggregate increase in actuarial value of pension plans accrued during the year and all earnings on deferred compensation that is not tax-qualified.
- Perquisite disclosure would be itemized, and the threshold for perquisite disclosure would fall to \$10,000, from its current level of \$50,000 or 10% of salary and bonus. Interpretive guidance would be provided to describe what qualifies as a perquisite.
- Two tables would report grants of performance-based awards and grants of all other equity awards.

2. Equity Holdings

Two tables would be the heart of this disclosure:

- Outstanding Equity Awards at Fiscal Year-End – showing outstanding equity awards that represent potential amounts that may be received in the future.
- Option Exercises and Stock Vested Table – showing amounts realized on equity compensation.

3. Retirement Plans and Post-Employment Payments or Benefits

Disclosure would include:

- Retirement Plan Potential Annual Payments and Benefits Table – showing annual benefits payable to each named executive officer.

- Nonqualified Defined Contribution and Other Deferred Compensation Plans Table – disclosing the year-end balance for any deferred compensation plans, each named executive’s contributions, the company’s contributions and all earnings and withdrawals for the year.
- Disclosure of payments and benefits (including perquisites) payable on employment termination or corporate change in control, including quantification.

4. Director Compensation

A new Director Compensation Table, like the Summary Compensation Table for executives, and related narrative would disclose director compensation for the past year.

Related Person Transactions

The proposed rules would update, clarify and slightly expand disclosure requirements for related person transactions. The proposed changes include a disclosure requirement regarding policies and procedures for approving related party transactions, a slight expansion of the categories of related persons, and an increase in the threshold for disclosure (to \$120,000 from \$60,000). The disclosure requirement would be made more principles-based, requiring disclosure if the company is a participant in a transaction in which a related person has a direct or indirect material interest.

Director Independence

Proposed new Item 407 of Regulation S-K would require:

- Disclosure of whether each director and director nominee is independent.
- Description of any relationships not otherwise disclosed that were considered when determining whether each director and director nominee is independent.
- Disclosure of any audit, nominating and compensation committee members who are not independent.

Corporate Governance Matters

Proposed Item 407 would consolidate various requirements for corporate governance disclosures that are currently scattered throughout the proxy rules and Regulation S-K. This would include disclosure regarding board meetings and committees, and specific disclosure about audit committees, compensation committees and nominating committees. It would also require a narrative description of compensation committee procedures for determining executive and director compensation.

Security Ownership

The proposed rules would require disclosure of the number of shares pledged by the company’s officers and directors.

Form 8-K Modifications

The proposed rules would modify the disclosure requirements of Form 8-K, to require disclosure of some employment arrangements and material amendments for named executive officers. All Form 8-K disclosures about employment arrangements would be consolidated under a single item.

Plain English

Plain English principles would be required to be applied to most of the new required disclosure. Staff comments on future filings would enforce these new requirements over time.

Conclusion

The SEC has not yet released the text of its newly-approved rule proposals. As is often the case, important aspects of the proposed rules will be found in the details of their text. Once promulgated, the proposal will undoubtedly be the topic of extensive public comment. We anticipate that final rules will be adopted in time to apply to the 2007 proxy season.

We will provide our analysis of these rules when they are promulgated and when they are adopted. If you would like information on how to comment on the proposals, or if you wish to discuss the implications for your company of the potential changes in this disclosure requirements, please contact any member of your Fenwick & West team, or Horace Nash (650.335.7934 - hnash@fenwick.com), Scott Spector (650.335.7251 - sspector@fenwick.com) or William Herochik (650.335.7131 - wherochik@fenwick.com).

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