



FENWICK & WEST LLP

Corporate and Securities Law Update

SEC Proposes New Rules for Executive Compensation Disclosure—The Details Emerge

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The SEC has now made available the text of its rule proposals covering executive compensation and related party transaction disclosure. A copy of the 370-page release is available at this link: <http://www.sec.gov/rules/proposed/33-8655.pdf>. In our January 18, 2006 Alert, available here – http://www.fenwick.com/docstore/publications/Corporate/sec/Corp_Sec_01-18-06.pdf – we summarized the broad sweep of these rule proposals, and we expect to provide detailed analysis in the future.

In the following bullets we take note of several aspects of the rule proposals that struck us as particularly interesting to technology companies.

Compensation Discussion and Analysis. The proposal would require Company management to provide extensive “principles-based” discussion of the Company’s compensation philosophy, a description of the varying components of compensation, and the reasons and justifications why some individuals were compensated the way they were. The extent to which executive officers participated in the compensation process would be included in the discussion. The accounting and tax ramifications of compensation would be disclosed – requiring the Company to interact with its accountants and tax advisors when preparing its proxy. The proposals would eliminate the Compensation Committee Report, reflecting the SEC’s express view that this disclosure had not served its intended purpose because it had become mere “boilerplate.” The rule proposals and accompanying narrative discussion contain strong language directing companies to provide company-specific disclosures in the new CD&A, so that it does not suffer from a similar malaise.

Corporate Governance Disclosure. The proposed new rules would also require disclosure of the processes and procedures the Company used in determining its executive compensation. Reviewing the SEC’s examples of the types

of processes and procedures that would require disclosure makes clear why this might be sensitive:

- the scope of authority of the compensation committee
- the extent to which the compensation committee may delegate authority, and to whom it may be delegated
- whether the compensation committee’s authority is set forth in a charter or other document and if so where a copy of it can be located
- any role of executive officers in determining or recommending the amount or form of executive and director compensation
- identification of any compensation consultants who were involved in the process of determining compensation, describing the scope of their involvement and who engaged them

Compensation Tables. The complex tabular presentations mandated under the proposal raise concerns that compensation will in essence be double counted. Five different but related tables are called for in the proposals, along with narrative disclosure about each. For example, in the Summary Compensation Table a company must report the value at grant of a stock option, at full FAS 123R valuation. In a subsequent year, the company would also be required to report on the value of any options that are modified (in a manner that is different than the mandated valuations under FAS 123R), and to explain that some or all of this was value previously reported as compensation in a previous disclosure.

Perquisites. The proposal contains SEC guidance about what constitutes a perquisite, including illustrative examples. Companies should keep this helpful guidance in mind in preparing proxy statement disclosures about perquisites in 2006. Further, the SEC stated in no uncertain terms that

the “incremental value” method is the only permissible method of valuing perquisites – other methods that may be permissible by the IRS or other authorities may not be used in this context. The SEC also confirmed once again its view that all elements of executive compensation are required to be described in 2006 under the current disclosure regime.

Termination and Change in Control Payments. The proposed rules would require companies to disclose all payments that are payable to executives in the event of a termination of employment or a change in control of the Company. The type of payment or benefit and the amount must be disclosed. Determining the amount of the payment could prove to be problematic – particularly in the case of acceleration of equity awards or parachute payment tax gross-ups – due to the fact that valuation requires assumptions about the company’s future share price. This forward-looking disclosure could be extremely sensitive, of course.

We will analyze and update you on the potential impacts of these rules on technology companies. If you would like to comment on the proposals to SEC staff, or if you wish to discuss the implications of the changes for your company, please contact any member of your Fenwick & West team, or Scott Spector (650.335.7251 - sspector@fenwick.com), Horace Nash (650.335.7934 - hnash@fenwick.com), William Herochik (650.335.7131 - wherochik@fenwick.com) or Paul Nelson (650.335.7227 – pnelson@fenwick.com).

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