



## SEC Disclosure: Revamping the Executive Compensation Rules

On August 11, 2006, the Securities and Exchange Commission (the “SEC”) adopted sweeping changes to its executive compensation disclosure rules.<sup>1</sup> Despite the resemblance of some of the new tabular disclosures to their predecessors, the new rules dictate disclosure of unprecedented detail regarding all elements of executive officer and director compensation and may cause many companies to revisit their overall approach to compensation decisions. This advisory briefly reviews the origins of the new rules, offers some suggestions for building the disclosures, and summarizes key elements of the new disclosure regime.

The new rules were foreshadowed, at least in part, in Division of Corporation Finance Director Alan L. Beller’s “all-means-all” speech in October 2004. *Remarks Before the Conference of the NASPP, The Corporate Counsel and the Corporate Executive (October 20, 2004)*. In that speech, Mr. Beller acknowledged that “executive compensation is undeniably a ‘hot topic,’” citing concerns expressed by shareholders and groups that represent their views and what he perceived as a pattern of “opaque or unhelpful disclosure” that states “as little as possible while seeking to avoid liability, rather than disclosure that seeks to inform.”

Against this background, the SEC’s new executive compensation rules embrace what the rules describe as a principles-based disclosure philosophy and broad disclosure requirements intended to capture all elements of current and future compensation practices. Largely rejecting the exclusive tabular approach adopted in 1992, the new rules combine more comprehensive tabular disclosure with extensive narratives. Compensation disclosure also must be preceded by a “Compensation Discussion and Analysis” section (“CD&A”) that calls for a comprehensive discussion of the material factors underlying compensation

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<sup>1</sup> Executive Compensation and Related Person Disclosure, Release No. 33-8732A, 71 Fed. Reg. 53,157, 53,158 (Sept. 8, 2006) (also available at <http://www.sec.gov/rules/final/2006/33-8732afr.pdf>).

policies and decisions. Following the CD&A, tabular disclosure must be provided in three broad categories:

- Compensation with respect to the last fiscal year (and two preceding fiscal years) in a revised Summary Compensation Table and a supplemental table that reports the terms of performance-based awards and other equity awards;
- Holdings of equity-related interests that relate to compensation or are potential sources of future gains; and
- Retirement and post-employment benefits.

In addition to extensive tabular disclosure, additional narrative disclosure is required to convey additional detail regarding the information included in the tables.

## BUILDING THE TABLES AND THE CD&A

The new executive compensation disclosure rules will apply to all compensation decisions made in 2006. Because most compensation committees acted before the SEC adopted the new rules, decision-making processes and documentation for 2006 could not be informed by the new disclosure requirements. The new rules likely will require many companies to gather new information and examine elements of their compensation policies in a different light. In addition, the CD&A

will be covered by the CEO's and CFO's certifications included in annual reports. This means that the CD&A is subject to a company's disclosure controls and procedures and should be prepared with the same care and attention to detail as other sections of the annual report and proxy statement. Accordingly, those responsible for drafting the proxy statement for the 2007 annual shareholder meeting should get an early start, plan for multiple drafts, and schedule meetings with senior management and the compensation committee.

Although most commentary has focused on the CD&A, many companies may find that drafting the CD&A should be the last step in the disclosure process. Disclosure controls and procedures vary from company to company, but in preparing the new disclosures, common steps to consider might include:

- **Assemble a multidisciplinary disclosure team** — Depending on a company's specific compensation programs, preparing the tabular and narrative disclosures will require input from human resources, treasury and finance, benefits, tax, legal, and possibly other departments. A number of the mandatory equity compensation disclosures, for example, are based on the application of FAS 123(R):

Share-Based Payment ("FAS 123R"). Developing a strategy and timeline for coordinating multiple departments, assembling data, and building the disclosures is critical to complying with the new rules.

- **Gather data** — Using the columns in the tables as a guide, companies should gather all necessary compensation information, including employment agreements, benefit plans, fringe benefits policies and W-2 information. The disclosure team should keep in mind, however, that income reported for federal income tax purposes may not be the same as the compensation values required to be reported under the new rules.
- **Focus on sensitive issues** — Responding to the current option pricing controversies, the SEC has highlighted option grant practices as a key element of the CD&A and tabular and narrative disclosures. Companies should consider undertaking a careful examination of option practices — reviewing option plans and terms of prior grants — to identify potential issues. As part of this process, management might consider developing additional procedures and controls for the granting of options and other awards such as, for example, fixing the times of grants or

awards each year or developing a policy for new hires. Similarly, disclosure of perquisites continues to be a topic of intense interest and scrutiny for the SEC. The disclosure team should revisit elements of compensation that confer a personal benefit and apply the standards prescribed by the SEC.

- **Evaluate current compensation philosophy** — The disclosure team should consider reviewing materials provided to the compensation committee and the board in connection with compensation decisions and prior compensation committee reports. The disclosure team then should analyze the gathered data in relation to the stated compensation philosophy.

Having gathered the data, focused on and highlighted any sensitive issues, and evaluated the current compensation philosophy, the disclosure team now can begin to prepare the required disclosures. Drafts of the disclosures will need to be reviewed and revised several times to ensure compliance with the new rules.

## CD&A

The CD&A is the centerpiece of the SEC's new executive compensation disclosure rules. This overview requires a discussion and analysis of the material factors underlying a

company's compensation policies for its Named Executive Officers and its decisions as reflected in the data in the compensation tables, including post-termination benefits. The CD&A should address both the separate elements of executive compensation as reflected in the tables and a narrative discussion of executive compensation as a whole. In particular, companies must answer five key questions:

- What are the objectives of the compensation programs?
- What are the programs designed to reward?
- What is each element of compensation, and why does the company choose to pay each element?
- How does the company determine the amount (or, if applicable, the formula) for each element?
- How does each element of compensation and the company's decisions regarding that element fit into the company's overall objectives and affect decisions regarding the other elements?

The CD&A section is "principles-based," providing a conceptual framework for companies to follow rather than detailed rules. The new rules provide illustrative examples of factors to be considered. There is no "one size fits all" approach, and boilerplate disclosures, the SEC warns throughout the adopting

release, will not satisfy the rules. Each company will need to tailor the CD&A to fit its particular circumstances.

The final rules provide the following non-exclusive examples of issues to consider in responding to the questions for the CD&A:

- Policies for allocating between long-term and current compensation and cash and non-cash compensation;
- For long-term compensation, the basis for allocating compensation to each different form of award;
- How the determination is made when awards are granted, including equity-based compensation awards such as options;
- What specific items of corporate performance are used in setting compensation policies and compensation decisions;
- How specific elements of compensation are structured and implemented to reflect these items of the company's performance and the executive individual's performance (target levels with respect to specific performance-related factors need not be disclosed so long as they meet the standards of a confidential treatment request);
- Company policies and decisions regarding the adjustment or recovery of awards or payments

if the relevant company performance measures upon which such awards are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;

- The factors considered in decisions to increase or decrease compensation materially;
- How compensation or amounts realized from prior years' compensation are considered in setting other elements of compensation (such as retirement benefits);
- The basis for selecting particular events as triggering payment with respect to post-termination agreements;
- The impact of accounting and tax treatment on the company's decisions to have or not have particular forms of compensation;
- The company's equity or other security ownership requirements or guidelines and any company policies regarding hedging the economic risk of such ownership;
- Any benchmarking of total compensation; and
- The role of executives in the compensation process.

In many cases, last year's compensation committee report and materials provided to the compensation committee should

provide a good starting point for drafting the CD&A. The disclosure team should evaluate the data that it has gathered against historical policies and the questions and examples in the rules. Questions to ask might include:

- What patterns appear to emerge from the data?
- What do the patterns suggest about the weighting of each element of compensation?
- Are those patterns consistent with prior expressions of the compensation philosophy?

The CD&A should not simply repeat the detailed data included in the various compensation tables and related narrative disclosures. It should, however, discuss those figures and may even refer to them. The goal is to provide a robust and meaningful discussion and analysis of the company's executive compensation program and to explain how the compensation program furthers the company's strategic goals and objectives.

The CD&A section will vary each year, at least with respect to compensation decisions during the last fiscal year. Additionally, the CD&A section may not necessarily be limited to a discussion of compensation for the last fiscal year, and may require a discussion of post-termination and ongoing compensation arrangements, as well as policies of the company

that apply on a going-forward basis. A discussion of compensation in prior years also may be necessary to provide the proper context for the current year compensation disclosure.

The CD&A requirements will be effective for this year's proxy statement discussing compensation decisions made in 2006. Therefore, it is imperative that companies begin to consider the disclosure of compensation as soon as practicable.

## COMPENSATION COMMITTEE REPORT

The final rules retain an abbreviated Compensation Committee Report from the prior rules. Much like the Audit Committee Report, in the Compensation Committee Report, the compensation committee must state whether the compensation committee reviewed and discussed the CD&A with management, and based on that review and those discussions, whether the compensation committee recommended to the board of directors that the CD&A be included in the company's annual report on Form 10-K and, as applicable, the company's proxy or information statement. The compensation committee names will continue to follow the Compensation Committee Report, and the report will be "furnished," rather than filed with, the SEC.

## PERFORMANCE GRAPH

In light of the widespread availability of stock performance information, the proposed rules would have eliminated the Performance Graph. However, in light of the number of comments received on this proposal, the SEC decided to retain the requirements for the Performance Graph. The final rules move the graph to an item entitled “Market Price of and Dividends on the Registrant’s Common Equity and Related Stockholder Matters,” which will be “furnished” rather than filed and will be included in the annual report on Form 10-K. In addition, in an effort to separate stock performance from compensation decisions, the revised performance graph may include performance measures in addition to total return.

## THE NEW EXECUTIVE COMPENSATION TABLES AND NARRATIVE DISCLOSURES

The SEC has made clear through speeches and other commentary that the prior rules already required disclosure of “all compensation earned or paid, from all sources and services,” not solely those elements of compensation itemized in the prior rules. The amendments advance that philosophy by requiring “that all

elements of compensation must be disclosed,” except perquisites and personal benefits below \$10,000 in the aggregate per executive. In addition, as more fully discussed below, the amendments also include sweeping changes to the breadth and format of required compensation disclosure, including expanded tabular and narrative disclosure.

The rules reorganize the compensation tables and their related narrative disclosure into three categories:

- Compensation with respect to the last fiscal year (and two preceding fiscal years) in a revised Summary Compensation Table and a supplemental table that reports the terms of performance-based awards and other equity awards;
- Holdings of equity-related interests that relate to compensation or are potential sources of future gains; and
- Retirement and post-employment benefits.

### A. REVISED SUMMARY COMPENSATION TABLE

The rules continue to include a Summary Compensation Table as

the principal source for disclosure of executive compensation. After a three-year phase-in, the table requires, as before, disclosure of compensation for the last three completed fiscal years. However, there are several changes to the table, most notably two additional columns: the “Total” column and the “Non-Equity Incentive Plan Compensation” column.

### Named Executive Officers Covered

The final rules define the “Named Executive Officers” as the principal executive officer, the principal financial officer, and the three other most highly paid executive officers whose total compensation (as opposed to the current salary and standard bonus) exceeded \$100,000 during the last fiscal year. Total compensation excludes any changes in pension values and nonqualified deferred compensation above-market or preferential earnings from the total compensation calculation, because these values are not under the complete control of the company. However, total compensation must include cash payments even though not part of a recurring arrangement

Summary Compensation Table

Name & Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)



and unlikely to be repeated. With respect to a Named Executive Officer, other than the principal executive officer and the principal financial officer, companies may exclude an officer from the table if part of his or her compensation consists of cash payments attributed to overseas assignments.

The new rules regarding the principal financial officer follow the prior rules for a principal executive officer. Any individual who serves as a principal executive or financial officer during the year, even if he or she is no longer serving at the end of the fiscal year, must be included in this table. For example, if a company were to replace both the principal executive officer and the principal financial officer during the same fiscal year, seven names would appear in the Summary Compensation Table in the next proxy statement — the two principal executive officers for the last fiscal year, the two principal financial officers for the last fiscal year and the three other most highly compensated officers with compensation in excess of \$100,000. The rules also retain disclosure for up to two departed Named Executive Officers.

The proposed rules would have required total compensation and job description disclosure for up to three non-executive employees whose pay exceeds that of any of the Named Executive Officers, though

not disclosure of the names of such employees. The SEC chose not to adopt these proposals at this time, but is requesting additional comments on the proposal. The comment period will expire on October 23, 2006.

### ***Salary***

Earned compensation for which payment is deferred must be included in the salary, bonus, or other compensation columns of the Summary Compensation Table, as appropriate, unless such deferral is tax-qualified. Under prior rules, this item only applied to salary and bonus deferred at the election of the Named Executive Officer.

### ***Stock Awards and Option Awards***

The Stock Awards and Option Awards columns must include the dollar values of awards as opposed to numbers of shares. The dollar value of awards are calculated using the grant-date fair value of each award, determined pursuant to FAS 123R. The company must report any stock- or option-related awards that derive their value from the company's equity securities or permit settlement by issuance of the company's equity securities. Stock awards include restricted stock, restricted stock units, phantom stock, phantom stock units, and common stock equivalent units. Option awards encompass options, stock appreciation rights and similar equity-based compensation

instruments. The grant date fair value must appear as compensation in the year in which the company made the grant. Companies must disclose the number of shares underlying an award in the supplemental Grants of Plan-Based Awards Table.

### ***Non-Equity Incentive Plan Compensation***

The Non-Equity Incentive Plan Compensation column must report the dollar value of all amounts earned during the fiscal year pursuant to incentive plans that are not within the scope of FAS 123R. Companies must report payouts in the year in which the relevant specified performance criteria are satisfied, regardless of whether such compensation is actually paid in that year. The company will report the grant of an award in the supplemental Grants of Plan-Based Awards Table in the year of grant. As a result, a payout in the Summary Compensation Table may appear several years after the reporting of the award.

### ***Change in Pension Value and Nonqualified Deferred Compensation Earnings***

The Change in Pension Value and Nonqualified Deferred Compensation column includes information regarding the aggregate increase in actuarial value to the Named Executive Officers of all defined benefit and actuarial plans accrued over the year and

earnings on nonqualified deferred compensation that are “above-market or preferential.” The rules require footnote identification and quantification of the full amount of each element. Specifically, the amendments require disclosure of the following:

- the increase in value resulting from an additional year of service, compensation increases, and any plan amendments; and
- the increase or decrease in value attributable to interest.

Under the proposals, this information would have been included in the “All Other Compensation” column. By placing this information in a separate column, the SEC intends to allow investors to easily identify elements in the “Total” column that primarily relate to longevity of service. Companies will deduct the amount in this column from the “Total” column when determining who are the Named Executive Officers to include in the Summary Compensation Table.

#### ***All Other Compensation, Including Perquisites***

The new Summary Compensation Table includes a revamped “All Other Compensation” column. Except as discussed below, the SEC has emphasized that this column must include all other compensation not required to be included in another column.

The instructions to the All Other Compensation column specifically address perquisites and other personal benefits. This column must include the value of perquisites and other personal benefits, unless the aggregate value of all such benefits is less than \$10,000. In addition, the company must identify and separately disclose the value of perquisites worth more than the greater of \$25,000 or 10% of the total perquisites and personal benefits reported. The value of perquisites must be determined using the aggregate incremental cost to the company — not the compensation reported for income tax purposes. A footnote to the column should also disclose the methodology used to compute the aggregate incremental cost.

The SEC takes an expansive view of what constitutes a perquisite. According to the SEC, the following analysis should be utilized in determining whether an item is a perquisite or personal benefit:

- Is the item integrally and directly related to the performance of the executive’s duties? If so, it is not a perquisite.
- Otherwise, the item is a perquisite if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or the convenience of the company, unless it is generally available

on a non-discriminatory basis to all employees.

The SEC cautions that the concept of a benefit “integrally and directly related” to the executive’s duties is a narrow one, and that there is a critical distinction between an item that the company provides because the executive needs it to do his or her job and an item provided for some other reason, even if that reason involves a business purpose or company convenience. If the benefit is not “integrally and directly related,” the company must then analyze the benefit under the second prong of the test and determine if the item gives any “direct or indirect benefit that has a personal aspect” and is not generally available to all employees.

In the final rule, the SEC provided examples of perquisites or personal benefits that are required to be disclosed:

- club memberships not used exclusively for business entertainment purposes;
- personal financial or tax advice;
- personal travel using vehicles owned or leased by the company;
- personal travel otherwise financed by the company;
- personal use of other property owned or leased by the company,

and housing and other living expenses (including but not limited to relocation assistance and payments for the executive or director to stay at his or her personal residence);

- security provided at a personal residence or during personal travel;
- commuting expenses (whether or not for the company's convenience or benefit); and
- discounts on the company's products or services not generally available to employees on a non-discriminatory basis.

The final rules also provide the following non-exhaustive list of additional items to include in the "All Other Compensation" column, all of which formerly appeared in either the "All Other Compensation" or "Other Annual Compensation" column:

- amounts paid or accrued pursuant to a plan or arrangement in connection with any termination of employment or change of control;

- annual company contributions to vested and unvested defined contribution plans;
- the dollar value of any life insurance premiums paid by the company for the benefit of a Named Executive Officer;
- "gross-ups" or other amounts reimbursed during the year for the payment of taxes;
- the compensation cost, computed according to FAS 123R, of any company security purchased from the company at a discount from the market price, unless the discount is generally available to company employees; and
- dividends or other earnings on stock or option awards that were not factored into the fair value on the date of grant.

### **Total**

The new Total column provides a summation from left to right the dollar amount of each distinct form of compensation quantified in the other columns of the Summary Compensation Table. The SEC intends this new column to provide

comparability of compensation between companies and within a company over several years.

### **Narrative Disclosure**

The new SEC rules require narrative disclosure following the Summary Compensation Table. Companies must discuss any additional "material factors necessary" to understanding the information included in the columns in the narrative disclosure. For a more detailed discussion of the narrative disclosure requirements, see Part B.2 on the next page.

## **B. NEW EQUITY BASED TABLES**

### **1. Grants of Plan-Based Awards**

The new rules provide for a supplemental table to the Summary Compensation Table for equity- and performance-based awards granted to the Named Executive Officers during the last fiscal year. This table provides the number of shares underlying the awards reported in the Summary Compensation Table.

Disclosure in the table is on a grant-by-grant basis —

**Grants of Plan-Based Awards**

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards; Number of Shares of Stock or Units (#)	All Other Option Awards; Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards (\$/Sh)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (\$)	Target (\$)	Maximum (\$)			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)



aggregation of option grants with the same exercise or base price is not permitted. Companies must disclose the threshold, target and maximum values required for non-equity incentive plan awards and equity incentive plan awards whether one-year or multi-year awards. If an award only provides for a single estimated payout, that amount must be reported as the target. If a target is not determinable, companies must provide a representative amount based on the prior year's performance.

In response to the current controversy surrounding option grants, if the per-share exercise or base price of the option is less than the market price of the underlying security, the table must include a separate column showing the market price (the last sale price on the principal U.S. market for the security ) on the grant date (as determined by FAS 123R). A description of the methodology used to determine the exercise or base price is required if that price is not the grant date closing market price. In addition, if the compensation committee takes action to grant equity-based awards on a date different from the grant date, companies must add a column disclosing the date of action.

## 2. Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table

Narrative disclosure following the Summary Compensation Table and the Grants of Plan-Based Awards Table must discuss any additional "material factors necessary" to understanding the quantitative information included in the tables. This commentary should provide specific context for the figures listed in the tables and, combined with the CD&A, should aid in preventing the "double counting" of amounts listed in more than one table. The narrative section is distinct from the CD&A section in that the CD&A should address broader topics regarding the objectives and implementation of compensation policies, while the narrative section should focus on aiding the understanding of the specific amounts disclosed in the tables. In its release, the SEC offers the following examples of potentially material factors companies should discuss in the narrative section:

- repricing or other material modifications of any outstanding option or other equity-based awards, including the extension of exercise periods;

- change of vesting or forfeiture conditions;
- change or elimination of applicable performance criteria; and
- change of the bases upon which returns are determined.

The narrative disclosure should also address, to the extent material and necessary to an understanding of the table, award terms relating to the figures provided in the Grants of Plan-Based Awards Table. Examples of such terms companies must discuss include:

- a general description of the formula used to determine the amounts payable;
- the vesting schedule;
- a description of any material conditions applicable to the award;
- whether dividends or other amounts will be paid; and
- the applicable return rate and whether that rate is preferential.

## 3. Outstanding Equity Awards at Fiscal Year-End Table

The Outstanding Equity Awards at Fiscal Year-End Table shows outstanding awards to Named Executive Officer under stock incentive plans and the cumulative value of those awards

## Outstanding Equity Awards at Fiscal Year-End

Name	Option Awards					Stock Awards			
	No. of Securities Underlying Unexercised Options Exercisable (#)	No. of Securities Underlying Unexercised Options Unexercisable (#)	Equity Incentive Plan Awards: No. of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price (\$)	Option Expiration Date	No. of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	Equity Incentive Plan Awards: No. of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)

## Option Exercises and Stock Vested

Name	Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
(a)	(b)	(c)	(d)	(e)

as of the end of the most recent fiscal year. Under the prior rules, companies only provided this information for outstanding stock options and appreciation rights and in a footnote to the restricted stock column of the Summary Compensation Table. Disclosure is required for each option or stock award on a grant-by-grant basis.

For options, stock appreciation rights and similar instruments having option-like features, the rules require disclosure of the number of securities underlying unexercised instruments that are exercisable or unexercisable (including out-of-the-money awards), the exercise or base price, and the expiration date.

For restricted stock, restricted stock units and similar instruments that do not have option-like features, the rules require disclosure of the number of unvested shares and the value of those unvested units. The company must also disclose the unearned shares granted as part of an equity incentive plan and the market value of those unearned shares (market value being based on closing price of stock at the end of the previous fiscal year).

### 4. Option Exercises and Stock Vested Table

The new rules require a table to record the value a Named Executive Officer received upon exercise of options or similar

instruments or the vesting of stock or similar instruments during the most recent fiscal year.

The table is divided into two sections, one for stock awards, and another for option awards. Both require stating the number of shares acquired on vesting or exercise and the corresponding value realized. Disclosure of grant-date fair value is not required in this table.

### C. ENHANCED DISCLOSURE OF THE NATURE AND SCOPE OF SEVERANCE AND RETIREMENT BENEFITS

The new rules require significantly expanded reporting of retirement, change-in-control, and post-employment benefits. The new rules include:

## 1. Pension Benefits Table

The new rules require a Pension Benefits Table that sets forth the present value of the Named Executive Officer's accumulated defined pension benefits and the number of years of credited service regardless of the form of the benefit.

Companies must use generally accepted accounting principles to estimate the present value of the pension benefit based on current compensation. Companies also must describe the valuation method in the accompanying narrative.

The new rules also move the column disclosing pension benefits paid to Named Executive Officers from the Summary Compensation Table to the Pension Benefits Table. A narrative summary following the table must, to the extent applicable, address matters such as:

- the material terms and conditions of benefits available under the plan, including the plan's retirement benefit formula and eligibility standards, and early retirement arrangements;
- the specific elements of compensation, such as salary and various forms of bonus, included in applying the benefit formula, identifying each such element;
- regarding participation in multiple plans, the different purposes for each plan; and
- the company policies with regard to such matters as granting extra years of credited service.

## 2. Nonqualified Deferred Compensation Table

To provide investors with a more complete picture of post-employment benefits, the final rules include a new Nonqualified Deferred Compensation Table. This new table will require cumulative disclosure

of all nonqualified deferred compensation. This table will reflect all deferred amounts even if previously reported in the Summary Compensation Table. The table requires disclosure of all contributions, earnings, withdrawals/distributions for each Named Executive Officer during the last fiscal year, as well as the total value at year end. Amounts from tax-qualified plans that provide deferred compensation, such as 401(k) plans, do not have to be included.

In order to prevent double counting of compensation by investors, the new rules require that companies provide a footnote showing the amount of money in the contribution and earnings columns also reported in the other required tables. Despite the footnote, the revised format may present an initial impression of greater compensation than is accurate in some cases.

**Pension Benefits**

Name	Plan Name	Number of Years of Credited Service (#)	Present Value of Accumulated Benefit (\$)	Payments During Last Fiscal Year (\$)
(a)	(b)	(c)	(d)	(e)

**Nonqualified Deferred Compensation**

Name	Contributions in Last FY (\$)	Registrant Contributions in Last FY (\$)	Aggregate Earnings in Last FY (\$)	Aggregate Withdrawals/ Distributions (\$)	Aggregate Balance at Last FYE (\$)
(a)	(b)	(c)	(d)	(e)	(f)

Following the table, companies must include a narrative description of material factors necessary to understand the information provided in the table. The SEC offered the following examples:

- the type(s) of compensation permitted to be deferred, and any limitations (by percentage of compensation or otherwise) on the extent to which deferral is permitted;
- the measures of calculating interest or other plan earnings (including whether such measure(s) are selected by the Named Executive Officer or the company and the frequency and manner in which such selections may be changed), quantifying interest rates and other earnings measures applicable during the company's last fiscal year. Where plan earnings are calculated by reference to actual earnings of mutual funds or other securities, such as company stock, it is sufficient to identify the reference security and quantify its return. This disclosure may be aggregated to the extent the same measure applies to more than one Named Executive Officer; and

- material terms with respect to payouts, withdrawals and other distributions.

### 3. Narrative Disclosure of Post Employment Payments

The new rules require narrative disclosure of the termination and change in control arrangements, including:

- the specific circumstances that would trigger payment(s) or the provision of other benefits (references to benefits include perquisites and health care benefits);
- the estimated payments and benefits that would be provided in each covered circumstance (including tax gross-ups), and whether they would or could be lump sum or annual, disclosing the duration and by whom they would be provided;
- the factors used to determine the appropriate payment and benefit levels under the various circumstances that would trigger payments or provision of benefits;
- any material conditions or obligations applicable to the receipt of payments or benefits, including but not limited to non-compete, non-solicitation, non-disparagement or confidentiality covenants; and

- any other material factors regarding each such contract, agreement, plan or arrangement.

The final rules require that the company calculate this information assuming that the triggering event occurred on the last day of the last completed fiscal year and using the price per share, if applicable, on that date. If the officer was not a Named Executive Officer on that date, then the calculation would be based on the actual triggering event date. The company can provide the payment or benefit information by referencing the Pension Benefits Table or the Nonqualified Deferred Compensation Table, unless the benefit changes are based on the triggering event. Benefits that are generally available to all employees and do not change in favor of the Named Executive Officers are not required to be disclosed. If there are any uncertainties, the forward-looking statement safe harbor covers the disclosed information.

### D. DIRECTOR COMPENSATION

The new rules require a separate compensation table for directors, which must include all director compensation for only the most recently completed fiscal year.

The Director Compensation Table contains the following columns and information:

#### Director Compensation

Name	Fees Earned or Paid in Cash (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)

#### **Name of Director**

Each director that served during the last fiscal year is listed unless the director is also a Named Executive Officer. Compensation paid to a Named Executive Officer for work as a director that appears in the Summary Compensation Table does not need to be included again in the Director Compensation Table. Companies may group multiple directors into a single row, if their compensation is identical, although for clarity, a company may list each director on a separate line.

#### **Fees Earned or Paid in Cash**

All director fees earned or paid in cash for services as a director must be disclosed. This must include all annual retainer fees, committee fees and meeting fees.

#### **Stock and Option Awards**

The Stock Awards and Option Awards columns include the dollar values of awards during the fiscal year as opposed to the number of shares. As in the Summary Compensation Table, companies must calculate the dollar values of awards using the fair value of each award on the date the company granted the award. Awards that must be included in these columns include

any stock-related awards that derive their value from the company's equity securities or permit settlement by issuance of the company's equity securities. The value must appear in the table for the year in which the company made the grant.

#### **Non-Equity Incentive Plan Compensation**

The Non-Equity Incentive Plan Compensation column must report the dollar value of all amounts earned during the last fiscal year pursuant to incentive plans that are not stock based. Companies must report the awards in the year directors earn them, regardless of whether the awards are actually paid in that year.

#### **Change in Pension Value and Nonqualified Deferred Compensation Earnings**

This column includes the increase of all defined benefit and actuarial plans accrued over the year and earnings on nonqualified deferred compensation that are "above-market or preferential." Unlike the information called for from Named Executive Officers, this table does not require cumulative disclosure of previously deferred amounts. Companies must identify the full amount of each element in footnotes.

#### **All Other Compensation**

This column contains all compensation not properly reportable in the other columns:

- all perquisites and other personal benefits, determined under the standards for executive officers in the Summary Compensation Table, if the total is \$10,000 or greater;
- all tax reimbursements;
- for any security of the company or its subsidiaries purchased from the company or its subsidiaries (through deferral of fees or otherwise) at a discount from the market price of such security at the date of purchase, unless the discount is generally available to all security holders or to all salaried employees of the company, the compensation cost, if any, computed in accordance with FAS 123R;
- amounts paid or accrued to any director pursuant to a plan or arrangement in connection with the resignation, retirement or any other termination of such director or a change in control of the company;
- annual company contributions



to vested and unvested defined contribution plans;

- all consulting fees;
- awards under director legacy or charitable awards programs;
- the dollar value of any insurance premiums paid by, or on behalf of, the company for life insurance for the director's benefit; and
- the dollar value of any dividends or other earnings paid in stock or option awards when the dividend or earnings were not factored into the grant date fair value.

#### **Total**

This column aggregates the dollar amount of each distinct form of compensation in the other columns of the Director Compensation Table.

Narrative disclosure of material information necessary to understand the information in the table must follow the actual table, similar to the Summary Compensation Table. Material information may include a description of standard compensation arrangements, and whether any director has a different compensation arrangement. A footnote is also required to show the total number of stock and option awards outstanding at the end of the fiscal year for each director.

#### **E. OTHER REVISED DISCLOSURES**

In addition to enhancing the disclosure of executive compensation, the SEC made changes to a number of other

disclosure items. Each is briefly addressed below.

#### **1. Related Party Transactions**

The new rules clarify and expand the required disclosure regarding related party transactions, including the disclosure of policies and procedures for approving related party transactions and expanding the categories of related parties. In keeping with a "principles-based" approach, the new rules eliminate many of the instructions that provided bright-line tests for determining whether a company must disclose related party transactions.

The new rules increase the threshold for disclosure of transactions (including indebtedness) from \$60,000 to \$120,000. The SEC points out, however, that amounts below \$120,000 still may be material based on the facts and circumstances. The rules also expand the definition of immediate family members to include stepchildren, stepparents and any individuals sharing the household of a related person (other than an employee or tenant). Companies must report the amount involved in dollars regardless of the currency used in the transaction. Companies must disclose promoter information if it had a promoter during the last five years.

The new rules provide examples of transactions that do not require disclosure, including: compensation to an executive officer if the compensation is already reported or not required to be reported; certain types of indebtedness such as loans undertaken in the ordinary course of business under substantially the same terms as a non-related person would receive; and pro rata dividends or returns on the ownership of equity securities. Also, an instruction specifies when a person associated with a corporation or other entity engaged in a transaction with the issuer will not be deemed to have an indirect interest.

#### **2. Corporate Governance**

The amendments require disclosures about the compensation committee that are similar to the disclosures required for the audit committee and nominating committee. The company must disclose whether the compensation committee has a charter and whether it is available on the company's Web site. The company must describe the compensation committee's processes and procedures for the consideration and determination of executive and director compensation. Finally, the company must disclose any relationships members of the

compensation committee have with compensation consultants used by the company.

The new rules require companies listed on a national exchange to identify the independent directors of the company and nominees for director under the applicable listing standards. The rules also require disclosure of any members of the compensation, nominating and audit committees that are not independent. If the company is not listed, the company must use one of the standards of a national securities exchange or a national securities association and make the applicable disclosures. The company must also disclose any exemptions. Companies must disclose any transactions, relationships or arrangements not disclosed pursuant to Item 404(a) of Regulation S-K that were considered by the board of directors in determining that the independence standards were met.

### 3. Pledged Securities

The new rules require the table of beneficial ownership required by Item 403 of Regulation S-K to disclose of the number of shares pledged as security (i.e., for a loan) by Named Executive Officers either by footnote or otherwise.

## EXCEPTIONS AND MODIFICATIONS FOR CERTAIN ISSUERS

### A. Small Business Issuers

Small business issuers are only required to complete the Summary Compensation, Outstanding Equity Awards at Fiscal Year-End and Director Compensation tables, along with related narrative discussions, including footnotes. In addition, in the Summary Compensation Table, the small business issuer will only need to disclose information about the principal executive officer and the two most highly compensated executive officers. Finally, the small business issuer will not be required to provide a CD&A.

### B. Foreign Private Issuers

The new rules for foreign private issuers remain largely unchanged from the prior rules. Under the prior rules, and as adopted, foreign private issuers treatment under the Executive Compensation section, Item 402 of Regulation S-K parallels that under Form 20-F. However, under the final rules, foreign private issuers only need to file an employment or compensatory plan if they have otherwise publicly disclosed such a plan. In addition, disclosure of individual compensation is only required if the home country requires such disclosure.

### C. Business Development Companies

Under the final rules, business development companies must disclose all of the same executive compensation information as any other company. The individuals covered for business development companies include the same officers as for operating companies. Business development companies are not required to disclose information about members of any advisory board and certain other affiliated positions not covered under the new rules for other companies.

## FORM 8-K DISCLOSURES

In addition to revising the rules relating to disclosure of executive compensation, the SEC amended Form 8-K to reduce the number of filings relating to routine compensation decisions. The amendments are intended to elicit information regarding director and executive officer compensatory plans, contracts and arrangements that are “unquestionably or presumptively material.”

First, the SEC modified the coverage of Item 1.01, Entry into a Material Definitive Agreement, and Item 1.02, Termination of a Material Definitive Agreement, to carve out employment agreements and arrangements. This change does not affect the obligation to file such agreements

and arrangements as exhibits with appropriate reports.

Second, the SEC revised Item 5.02, Departure of Directors or Certain Officers; Election of Directors; Appointments of Certain Officers; Compensatory Arrangements of Certain Officers, as follows:

- to require disclosure regarding the departure of any Named Executive Officer;
- to expand the disclosure required by current Item 5.02 beyond employment agreements and require a brief description of any material plan, contract or arrangement to which a covered officer or a director is a party or in which he or she participates; and
- to require a brief description of any new material compensatory plan, contract or arrangement to which a Named Executive Officer is a party or in which he or she participates, as well as any material amendments, material grants, or modifications of a grant (unless consistent with the previously disclosed terms and disclosed when compensation disclosure is required).

Finally, if a company cannot calculate a Named Executive Officer's salary and bonus for the last fiscal year for inclusion in the proxy statement, Item 5.02(f) will require the company to file a Form 8-K when the amount becomes known.

The new rules extend the safe harbor provision use of Form S-3 for failure to file reports in a timely manner to employment agreements or arrangements. The new Form 8-K requirements will apply to triggering events occurring on or after November 7, 2006.

### EFFECTIVE DATES FOR THE NEW RULES

Compliance with the new rules is required as follows:

- for Forms 8-K for triggering events that occur 60 days after publication of the new rules in the Federal Register, which is on or after November 7, 2006;
- for Forms 10-K and 10-KSB for fiscal years ending on or after December 15, 2006.
- for proxy or information statements filed on or after December 15, 2006 that are required to include executive compensation and related person disclosure for fiscal years ending on or after December 15, 2006; and
- for registration statements pursuant to the Securities Act of 1933, as amended, and the Securities and Exchange Act of 1934, as amended, which are required to include executive compensation and related person disclosure for fiscal years ending on or after December 15, 2006.

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*This advisory should not be construed as providing legal advice. If you have any questions, feel free to contact your Arnold & Porter attorney or any of the attorneys listed below.*

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