



SEC Issues Proposals for Expanded Executive Compensation Disclosure

January 18, 2006

As expected, the Securities and Exchange Commission (SEC) approved yesterday the release of proposals to amend its disclosure requirements with respect to executive compensation. The proposals will affect the disclosure in proxy statements, annual reports, prospectuses and Forms 8-K. The proposed amendments are in response to the growing controversy surrounding what is viewed as excessive executive compensation and the difficulty faced by investors and analysts in determining the total value of an executive's compensation package. The proposals also are intended to modernize those requirements in the face of new compensation practices. New SEC Chairman Christopher Cox has made this issue one of his early priorities.

The proposals will not apply to the 2006 proxy season, but companies considering early compliance with the requirements should study the proposals in connection with the preparation of their 2006 proxy statements. Comments on the proposals will be due 60 days following the publication of the proposals in the Federal Register, which is expected by the end of this month.

Although the SEC has not yet published the actual proposals, the proposals can be described in general terms based on the materials disseminated and the statements of the staff and Commissioners at the meeting. Please note that this description is preliminary based on yesterday's SEC discussions and summary and will undoubtedly need to be refined and appended when the full proposing release is available.

As a general matter, the compensation disclosure will be divided into three sections: (1) current compensation paid within the last three years; (2) holdings of equity incentives that can provide future gains; and (3) post-termination payments, including pension, severance and change-in-control payments. Small business issuers will be subject to simplified disclosure rules. The significant specific changes include the following:

- **Plain English Disclosure**—The plain English rules that currently apply to prospectuses will be applied to executive compensation disclosures in proxy statements. Companies should begin reviewing their current disclosures this year in anticipation of this requirement.
- **Summary Disclosure**—The disclosure requirement will include a Compensation Discussion and Analysis section to explain the company's compensation practices, including a description of the compensation objectives and elements. The disclosure must be company specific and not boilerplate. This section will replace the compensation committee report and performance graph. Unlike the compensation committee report, the new summary discussion will be deemed a company disclosure filed with the SEC, which is subject to liability and CEO and CFO

certifications.

Section 1, Current Compensation

- Disclosure of Total Compensation—To permit shareholders to assess the value of the executive's total annual compensation, the summary compensation table will have a new first column calling for a total annual compensation figure. A number of companies are already providing this type of disclosure. See the article titled "They Say Jump: SEC Plans Tougher Pay Rules," in the January 11, 2006 issue of *The Wall Street Journal*.
- Option Grant Disclosure—Option grants and other equity awards and rights will have to be represented as the grant date fair value (as computed under SFAS No. 123(R)), rather than as the number of shares subject to the options. The full value of the options will be reflected in the year of grant, not over the term of the options, and the full value of re-priced options will have to be included, not just the net increase.
- Perquisites—The threshold for disclosure of perquisites in the All Other Compensation column will be \$10,000, down from the current threshold of \$50,000, or 10% of aggregate salary and bonus, whichever is lower. Perquisites representing more than \$10,000 in value will have to be itemized. Interpretive guidance on identifying, valuing and reporting perquisites, presumably including personal use of aircraft and other noncash benefits, will be included in the SEC release.
- Deferred Compensation—The increased actuarial value of pension plans and earnings on all nonqualified deferred compensation plans will be included in the All Other Compensation column.

Section 2, Outstanding Equity Awards

- Outstanding Equity Awards and Vesting Tables—These tables will inventory outstanding equity awards, including exercise price, and disclose the vesting schedule.
- Option Exercise Table—Disclosure of exercised options and value realized will be required. For comparison purposes, and to address the risk of double-counting, the grant date fair value previously disclosed for the year of grant in the summary compensation table will be repeated in this table.

Section 3, Post-Employment Benefits

- Post-Employment Benefits Table—The current pension plan table will be replaced by a new executive retirement benefits table that will require disclosure of the potential annual payments and benefits for executives. An aggregate amount and an amount for each named executive officer will be required. All post-employment benefits, including perquisites, will have to be listed and a dollar value will have to be assigned to those perquisites. Severance and change-in-control payments will likewise be covered.
- Nonqualified Defined Contribution and Other Deferred Compensation Plan Table—A new table will disclose the increased actuarial value of benefits under a defined benefit plan as well as company contributions and earnings on the account balance for the year in defined contribution plans.

Other Changes

- Director Compensation—A table similar to the summary compensation table will be required with respect to director compensation, but the table will cover only one year of compensation.
- Changes to Form 8-K Disclosure of Compensation Arrangements—Item 1.01 disclosures will be limited to compensation arrangements with named executive officers. All disclosure regarding employment arrangements will be consolidated under a single item.
- Related-Party Transactions—Item 404 requirements for disclosure of related-party transactions will be moved to a new item and conformed to the independence requirements of the applicable listing standards. The reporting threshold will be raised to \$120,000, from the current \$60,000. A company will have to disclose their policies and procedures relating to approval of related party transactions and the material factors that relate to the independence of a director that were considered by the board of directors, even if such factors are not specifically covered by a specific listing standard. Compensation committee disclosures similar to those now required for audit committees will be added.
- Share Ownership—Disclosure of the number of shares pledged by management will be required.

To assist our clients in preparing for the new executive compensation disclosure requirements, Morgan Lewis will host webcast presentations on February 7 and 8, 2006. The presentations will be of interest to any client considering early implementation of the proposals, as well as those who may consider submitting comments on the proposals. More information concerning these webcasts will be forthcoming. In the meantime, if you would like further information concerning the issues raised in this Morgan Lewis LawFlash, please contact the Morgan Lewis attorney with whom you generally discuss these issues or any of the following Morgan Lewis attorneys:

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