

July 28, 2006

SEC Approves Final Rules on Executive Compensation Disclosure

During a July 26 public meeting, the Securities and Exchange Commission ("SEC") unanimously adopted final and re-proposed rules on executive and director compensation disclosures (the "New Rules"). While the New Rules have not yet been published, comments at the SEC meeting indicate that they generally contain extensive changes substantially as proposed in the SEC Release 33-8655 on January 27, 2006 (the "Release").

A. Overview.

Revisions and additions in the New Rules are based on over 20,000 comments received by the SEC since the publication of the Release six months ago. One major addition is disclosure requirements for option grant practices. Revisions include changes to the treatment of retirement plans and the re-proposal of disclosure rules for non-executive employees.

We highlight below several revisions and additions to the Release that appear to have been incorporated into the New Rules based on comments at the SEC meeting. The New Rules also provide requirements in the following areas that we do not discuss here: related party transactions, director independence and other corporate governance matters.

Based on the SEC press release regarding the meeting, compliance with the New Rules generally will be required for any new proxy or information statements filed on or after December 15, 2006. For Form 10-K, compliance will be required for fiscal years ending on or after December 15, 2006.

B. Option Grant Practices.

At the top of SEC Chairman Cox's list of issues at the meeting, not surprisingly, were the requirements for stock option grant practices. The New Rules address two areas of concern relating to the granting of options: (1) the timing of grants and (2) the process of establishing the exercise price for an option.

1. **Timing.** The SEC's primary concern with timing involves the delayed or accelerated grant of options in connection with the release of material non-public information. The New Rules require a company to describe in the Compensation Discussion and Analysis ("CD&A") portion of its annual proxy its option grant practices and how it determines the timing for option grants. If a company coordinates its option grants with the release of material non-public information, the CD&A must address additional issues such as:

- ❖ the role of the Compensation Committee in approving the timing of option grants for executives;
- ❖ the role of the executive officers in the grant process; and

- ❖ whether grants to new executives are handled in a similar manner.

2. Establishing Exercise Price. Generally, options are granted with an exercise price equal to the fair market value of a company's shares on the date of grant ("FMV"). The New Rules require the following tabular disclosure related to option grants and exercise prices:

- ❖ the "grant date" as determined pursuant to Financial Accounting Standard No. 123 (rev. 2004), Share-Based Payment ("FAS 123R");
- ❖ the date the compensation committee of the board of directors took action to grant the option, if that date is different than the grant date;
- ❖ the full value of the option on the grant date based on FAS 123R; and
- ❖ if the exercise price is less than FMV, a separate column showing the "in-the-money" amount as of the grant date and a description of the methodology for determining such exercise price.

It is worth noting that we expect the New Rules will not use the terms "backdating" or "spring loading," and will permit the grant of options with exercise prices below FMV so long as the company complies with these disclosure requirements.

C. Retirement Plan and Post-Employment Disclosures. The New Rules make two significant changes to the treatment of retirement plans in the Release. First, both earnings on nonqualified deferred compensation and the annual increase in pension plan benefits will be excluded from total compensation for purposes of determining the highest paid executives for whom disclosure is required. Second, the summary compensation table will require disclosure of only above-market earnings, rather than all earnings, on nonqualified deferred compensation. In addition, the New Rules require the quantification of the potential payments and benefits in connection with an executive's termination or a company's change in control, assuming that the triggering event took place on the last business day of the company's last fiscal year and the price per share was the closing market price on that date.

D. Non-Executive Employee Disclosures. The New Rules re-propose the rules from the Release on the compensation of additional non-executive employees. The Release originally required narrative disclosure of the compensation for up to three non-executive employees if their total compensation for the most recent year was greater than that of any of the covered executives. The revised version of this requirement in the New Rules still requires disclosure of total compensation and a job description for up to three additional employees. However, this requirement only applies to companies that are large accelerated filers (i.e., greater than \$700 million in market capitalization) and to employees that make significant policy decisions either at the parent company or at a significant subsidiary or principal business unit. Thus, employees such as professional athletes, entertainment personalities, and stock brokers with no

policymaking authority would not be covered under the New Rules. Additional comments will likely be requested on this point.

E. Other Changes. The New Rules also make a number of other changes to the proposed rules in the Release. The performance graph and a brief version of the compensation committee report currently included in annual proxy statements will be retained. The compensation committee report will be similar to the audit committee report and state that the compensation committee has reviewed and discussed the CD&A with management and recommends to the board of directors that the CD&A be included in the company's annual report on Form 10-K and proxy statement. In addition, this report will be considered furnished rather than filed similar to the audit committee report.

* * *

Please call one of the following, or the firm attorney you regularly contact, if you have any questions about the New Rules.

Jeff Kroh..... (202) 861-5428
John McGuiness (202) 861-6625
Bill Sweetnam (202) 861-5427
Brigen Winters (202) 861-6618