GROOM LAW GROUP

February 3, 2006

SEC Proposes Increased Proxy Disclosures on Benefits

On January 27, the Securities and Exchange Commission (the "SEC") released new rules proposing extensive changes to the rules that govern public company disclosures of executive and director compensation.[1] The SEC intends the new rules to improve the clarity and completeness of these disclosures.

One of the major changes is a requirement that a single figure for total compensation be provided for covered executives each year. This annual figure would include the value of option and other equity grants made and retirement benefits earned during a year. In addition, the rules would require dramatic changes to the disclosures on both retirement benefits and equity grants. We highlight below some of the key changes in the proposed rules.

Overview

The proposed rules follow the approach of the current rules with tables providing dollar amounts of particular compensation types and footnotes adding narrative explanations of the amounts shown on the chart. However, major changes are made to the current tables, including the elimination of certain tables. The proposed rules also require that narrative explanations be written in "plain English" and provide any information necessary to understand the numbers in the tables.

In addition to the revised compensation tables, a new "Compensation Discussion and Analysis" section would be required. This new section will discuss material factors underlying policies and decisions reflected in the compensation amounts disclosed. The report will replace the compensation committee report and company performance graph, which will no longer be required.

Expanded Summary Compensation Table

As noted above, the proposed rules require that a total compensation figure be included in the Summary Compensation Table (the "SCT") for each covered executive for each of the last three completed fiscal years. The amount in the new "total compensation" column of the SCT will equal the sum of the amounts in all the other columns (e.g., salary, bonus, equity awards). And as noted above, the value of equity grants made and retirement benefits earned during a year must be included in the SCT. Additional changes of interest to the SCT are as follows:

[1] SEC Release 33-8655. The Release also limits to some extent the benefits-related information required to be filed on a Form 8-K and provides new rules in the following areas that we do not address: related party transactions, director independence and other corporate governance matters.

GROOM LAW GROUP, CHARTERED
1701 Pennsylvania Ave., N.W. • Washington, D.C. 20006-5811
202-857-0620 • Fax: 202-659-4503 • www.groom.com

- All deferrals of salary and bonus, both elective and non-elective, must be disclosed in a footnote to the SCT (these will also be disclosed in the proposed nonqualified deferred compensation plans table described below).

- The value of equity awards granted during a year will be based on the grant date fair value used for accounting purposes.[2]

- For non-stock incentive awards, only amounts that have actually been earned are disclosed (as opposed to the value of new grants).

- Any compensation that is not reported in the other columns of the SCT must be disclosed under the "All Other Compensation" column, with footnote disclosure of items in excess of $10,000 (See below for treatment of perquisites). Examples of amounts that would be included in this catch-all column include the following:

    - increase in present value of benefits under defined benefit plans
    - earnings on nonqualified deferred compensation (not just above market earnings as under current rules)
    - employer contributions or other allocations to defined contribution plans
    - all premiums paid on life insurance for the executive

The proposed rules outline some narrative disclosures which may be necessary for the SCT, including:

- assumptions for determining increase in present value of defined benefit plan benefits (thus, the rules do not specify how these calculations are to be made)
- method of calculating earnings in deferred compensation plans
- description of an executive's employment agreement
- any re-pricing or other material modification of an option or SAR (such as change in vesting or extension of the expiration date)
- description of the conditions for performance-based awards and any material waiver or modification of the performance goals

Retirement Benefits Disclosures

The proposed rules significantly revise the current requirements for retirement benefits disclosure. Under the current rules, a separate Pension Plan Table provides limited information on potential benefit amounts under a company's defined benefit plans. As noted above, the value of annual actuarial increases in defined benefits and the amount of employer contributions to defined contribution plans will need to be included in the SCT. In addition, the proposed rules will require two tables with more details on retirement benefits summarized below.

---

[2] A footnote is required disclosing all assumptions made in the valuation, by reference to a discussion of those assumptions in the company's other SEC filings.

New Retirement Plan Table

A new "Retirement Plan Potential Annual Payments and Benefits Table" will disclose the estimated annual retirement payments under defined benefit plans for each covered executive. The following information must be provided for each qualified or non-qualified defined benefit plan in which an executive participates:

- plan name
- executive's years of credited service
- plan's normal and early retirement age
- estimated benefits at normal retirement age and early retirement age

The estimated retirement benefit amounts should be based on the form of benefit elected by the executive (e.g., single life annuity) and assuming no increase in pay. Presumably, where no election has yet been made, the default distribution form under the plan would be used. Additionally, the proposed rules require footnote disclosure of any credited years of service beyond actual years of service and any resulting benefit increase.

Disclosure of the lump sum value of these benefits is not required in all cases. However, if a plan allows for a lump sum election, the rules indicate that the narrative following the table should indicate the value of the lump sum at the end of the most recent year and the assumptions used to calculate the amount.

A narrative description of each plan's provisions would follow the table if needed for an understanding of the amounts disclosed in the table. This narrative would address:

- material terms of each plan
- why, if there are multiple plans, such plans are maintained
- the compensation elements used in determining benefits
- policies regarding grants of additional years of service

New Nonqualified Deferred Compensation Plans Table

A new table will be required for non-qualified defined contribution plans, e.g., deferred compensation plans. This table will show the following amounts for each plan for the most recent year:

- executive contributions
- employer contributions
- earnings
- withdrawals and distributions
- ending balance

Unlike the current rules which require disclosure of only above-market earnings, the proposed rules require disclosure of all earnings. Additionally, the proposed rules require a footnote indicating the extent to which the contributions and earnings are reported in the SCT. This footnote requirement complements the footnote requirement in the SCT regarding the identification of amounts for which receipt has been deferred.

As with the defined benefit plan table, a narrative should accompany the table in order to provide a better understanding of the numbers in the table. This narrative could address the types of compensation permitted to be deferred, measures for calculating earnings, and distribution rules.

Equity and Incentive Award Disclosures

The current tables for equity compensation and incentive awards have been dramatically re-worked. Unlike the old tables which focused primarily on stock options and SARs, the new tables require similar disclosures for all equity awards, including restricted stock and restricted stock units. In addition, the separate Long-Term Incentive Plan Award Table has been eliminated, and disclosures on these types of awards (e.g., cash bonus based on three year performance cycle) are now provided in the same tables with equity awards. We summarize below the new tables.

Performance-Based Equity Grant Table

A new table will be required disclosing performance-based awards made to covered executives during the last year. This covers equity awards (including restricted stock, restricted stock units, options, and SARS) as well as non-equity awards, such as a cash bonus based on a three-year performance period. Disclosure must be provided of the performance period and the expected future payout amounts (either in dollars or number of shares) under three assumptions: minimum, target, and maximum.

Other Equity Grant Table

A separate table summarizes the key terms of other equity awards made during the last year that are not performance-based.

Outstanding Equity Awards Table

A third table will list the outstanding equity awards (such as options, SARS, restricted stock, and restricted stock units) for each covered executive as of the end of the last year. This table will also show the values of awards at such time, such as the value of "in-the-money" options and unvested restricted stock and restricted stock units.

Option Exercises and Restricted Stock Vesting Table

A fourth table will show the number of shares acquired by a covered executive on the exercise of an option or SAR or the vesting of restricted stock or restricted stock units during the most recent year, as well as the value realized by the officer on exercise or vesting. This table will also show the grant date fair value of these awards as previously reported in the SCT.

Equity Award Disclosures Eliminated

Because the proposed rules require disclosure of the grant date fair value of option and SARs in the SCT, the current disclosure in the Options/SAR Grants Table on the potential realizable value of such awards is eliminated. Similarly, the Ten-Year Option/SAR Repricings chart in the current rules is eliminated.

Rules for "Perks"

As noted above, perquisites and other personal benefits ("perks") provided to covered executives must be included in the SCT, subject to the following new rules:

- Narrative disclosures on perks are required unless the total value of the perks is less than $10,000. Disclosure is required under the current rules only if the value exceeds the lesser of $50,000 or 10% of the total annual salary and bonus.

- Unless the de minimis exception above applies, each perk must be identified in a footnote. If a perk is valued at $25,000 (or 10% of the total perks, if greater), then its "value" must also be disclosed.

- Perk values are still determined based on the aggregate incremental cost to the employer, rather than fair market value or other IRS standards (e.g., SIFL rates for airline travel).

The SEC declines to define the term "perk," but the rules do provide important guidelines on identifying perks, as well as a number of specific examples. Items that confer a direct or indirect benefit that has a personal aspect, unless available on a non-discriminatory basis to all employees, are considered perks. Items that are integrally and directly related to job performance, rather than merely facilitating job performance, are not perks. Finally, the SEC notes that it is not relevant to the determination that an item is deductible as an ordinary and necessary business expense, or is provided for some business reason or for the convenience of the company.

Severance and Change in Control Payments

As under the current rules, a narrative description of the materials terms of any arrangement providing for payments upon severance or change of control will be required. In addition, estimated payment amounts (and the method used to determine such amounts) must be provided for different payment triggers under such arrangements.

Covered Executives

The new disclosure requirements will apply to a company's principal executive officer, principal financial officer, and the three other most highly compensated executive officers (based on total compensation) serving at the end of the last completed fiscal year. Narrative disclosures could also be required 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. However, these individuals would not need to be named, and only their total compensation for the most recent year and job description would need to be disclosed.

Director Compensation

Because director compensation packages have become more complex, the proposed rules require disclosure of all director compensation for the most recent year in a table resembling the SCT. Although the proposed rules do not require tabular disclosure of director's outstanding equity awards, these awards would be disclosed in a footnote.

Effective Date

The proposed rules will not apply until after a 60-day comment period and the adoption of the final rules. Thus, the rules may well apply to proxies issued in 2007 which provide disclosures on 2006 compensation amounts.

Tax Implications

The IRS is now actively auditing executive compensation arrangements at large companies, and agents are instructed to review annual proxies and other SEC filings to gather information on the arrangements. Thus, these new rules will provide additional information for the IRS as they look for problems under relevant Code provisions (e.g., sections 162(m) and 409A). In addition, employers will also soon be reporting annual amounts accrued under nonqualified retirement plans subject to section 409 on executives' Forms W-2. Coordination between those preparing the annual accrual numbers for the proxy and those preparing similar numbers for the Forms W-2 seems advisable.

* * *

Please call one of the following, or the firm attorney you regularly contact, if you have any questions about the new SEC rules.

Liz Dold……..……………….. (202) 861-5406
Jeff Kroh……..………………. (202) 861-5428
Lou Mazawey ……………….. (202) 861-6608
John McGuiness ……………. (202) 861-6625
Bill Sweetnam ………………. (202) 861-5427