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**Recent Securities Law Developments on:
SEC's Proposed Changes to Disclosure Requirements
Concerning Executive Compensation**

On January 17, 2006, the Securities and Exchange Commission ("SEC" or "Commission") at an open meeting, voted unanimously to publish for comment a proposed revision to the executive compensation and related party transaction disclosure rules.¹ The proposed rules would affect disclosure in proxy statements, annual reports, and registration statements, and would modify the current reporting requirements of Form 8-K concerning compensation arrangements.

The text of the proposed rules has not yet been published although publication is expected soon. As a result, this memorandum is based on the SEC press release announcing the proposed rules as well as comments made during the course of the SEC open meeting announcing the proposal.

Comments on the proposed rules should be received by the SEC within 60 days of publication in the Federal Register.

I. Executive and Director Compensation

The proposed rules would modify the currently required disclosure concerning compensation to elicit clearer and more complete disclosure with respect to the five "Named Executive Officers" (to be defined as the principal executive officer, the principal financial officer, and the three other highest paid executive officers) and each of the directors. Further, disclosure would be required of up to three additional employees who are not executive officers if their compensation is higher than any one of the Named Executive Officers. Disclosure of these additional employees would be limited to the amount of

¹ See Securities Exchange Act of 1934, Press Release, "SEC Votes to Propose Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters," available at <http://www.sec.gov/news/press/2006-10.htm> (Jan. 17, 2006). The open meeting is archived at <http://www.connectlive.com/events/secopenmeetings/sec-011706-28k-archive.ram>.

compensation paid to each such individual and a description of their positions with the company. Disclosure of their names would not be required.

A. Compensation Discussion and Analysis

Under the proposed rules, the executive compensation disclosure section would begin with a “Compensation Discussion and Analysis,” an overview which would answer general questions concerning the company’s executive compensation policies and decisions, such as:

- What are the objectives of the company’s compensation policies?
- What are the compensation elements used to accomplish these objectives?
- For each element, why is it used, how does the company determine the amount, and how does that element fit into the company’s overall compensation objectives?

The goal of this new section is to “elicit meaningful disclosure of material information specific to companies, not boilerplate.” This new section would replace the current “Compensation Committee Report” and “Stock Performance Graph.” In addition, the new section would be required to be “filed” with the SEC, and not simply “furnished” as the Compensation Committee Report currently is. Therefore, liability under the Securities Act of 1933 and the Securities Exchange Act of 1934 would attach to the Compensation Discussion and Analysis disclosure (insofar as such disclosure is incorporated by reference into 1933 Act filings and 1934 Act annual reports) and such disclosure would be covered by the CEO and CFO certifications which are required exhibits to 1934 Act periodic reports.

B. Executive Compensation Section

Following the Compensation Discussion and Analysis, the next section would address executive compensation directly and in its particulars. Under the proposed rules, it would be divided into three categories: 1) compensation over the last three years; 2) holdings of equity-related interests received as compensation that are possible sources of future gain (including gains realized on these interests for the last three years), and 3) retirement and other post-employment compensation and benefits, including benefits conditioned on termination or change of control of the company.

1. Summary Compensation

The “Summary Compensation” table will continue to be the “principal disclosure vehicle” for disclosing executive compensation. Under the proposed rules, compensation would be disclosed for the last three fiscal years for each Named Executive Officer, and for the last fiscal year for each director, in the form of a table with the following five columns:

- Total compensation, which will be the sum of the values in other columns. The goal here was to respond to complaints that companies were not previously required to disclose the total value of executive compensation in one place in their public filings.

- Annual salary and bonus.
- Dollar value of stock- and option-related incentive awards at *grant date fair value*, calculated in accordance with FAS 123(R).
- Cash incentive awards not tied to the performance of company stock. This category of compensation will continue to be reflected in the year when the measure is satisfied and the payment is earned.
- All other compensation. Companies must include anything here that does not fall into other columns, which includes, for example, any increase in the actuarial value of the employee's pension and company contributions, any deferred compensation or tax gross-ups, and any perquisites or other personal benefits. Perquisites must be disclosed unless the aggregate of all such benefits is less than \$10,000. This threshold compares to the present threshold of the lesser of \$50,000 or 10% of the total annual salary and bonus of each Named Executive Officer.

For this table and others described below, the tabular material should be followed by additional narrative disclosure, including all material factors necessary for an understanding of information provided in the table.

The "Summary Compensation" table would be accompanied by two additional tables, a "Grant of Performance-Based Awards" table, including all performance-based awards, whether equity- or non-equity-based, and an "All Other Equity-Based Awards" table to capture those equity awards that are not performance-based.

2. Outstanding Equity Interests Received as Compensation

Under the proposed rules, the "Outstanding Equity Interests Received as Compensation" table would include two tables: an "Outstanding Equity Awards" table, showing the officer's fiscal-year-end holdings of such interests and their value, and an "Options Exercised and Stock Vested" table, showing amounts realized during the year from these interests. In the discussion at the SEC open meeting, the SEC Staff explained that this section, combined with the "Summary Compensation" section, is intended to give a complete picture of the value of executive compensation by disclosing option and equity holdings both at the date of the award and at the date of exercise or vesting, while avoiding double-counting for the same grant.

3. Retirement Plans and Other Post-Employment Payments and Benefits

Under the proposed rules, this area of disclosure would be significantly expanded, to include two tables: a proposed "Retirement Plan Potential Benefits" table, with specific amounts for each Named Executive Officer, including values as of the last fiscal year, and a proposed "New Non-qualified Defined Contributions and Deferred Compensation Plans" table, disclosing executive contributions, company contributions, aggregate earnings and withdrawals during the last fiscal year, and the total balance as of the last fiscal year-end. This section would require a description of any arrangement that provides for payments or benefits, including perquisites, provided on the occurrence of termination, change of respon-

sibility, or change of company control. This final item would require a quantification of estimated payments or benefits and disclosure of any assumptions used to make such a quantification.

II. Form 8-K Modifications for Compensation-Related Events

Currently Form 8-K Item 1.01 requires disclosure of compensation agreements and material amendments for all executive officers. Under the proposed changes, material compensation arrangements and amendments for Named Executive Officers would be “presumptively material.”

III. Modification of Disclosure Requirements for Related Party Transactions and Director Independence

Under the proposed rules, companies would be required to disclose their procedures related to the review, approval, and/or ratification of related party transactions. The threshold for disclosure of such transactions would be increased from \$60,000 to \$120,000. Also, many required disclosures related to director independence would be combined in a new disclosure section on director independence, and the company would be required to disclose whether each director is independent and the considerations made in determining whether each director is independent, including any relationships not otherwise disclosed. This disclosure is designed to be similar to the disclosure already required for listing on certain stock exchanges.

IV. Applicability and General Points

The proposed rules would require all proposed narrative disclosures to be written in plain English. The proposed rules would not apply in its entirety to small business issuers, but would contain certain substitute requirements for these issuers. The proposed rules would apply to business development companies in its entirety. The proposed rules will have no effect on the current requirements for foreign private issuers.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jonathan I. Mark at (212) 701-3100 or jmark@cahill.com; John Schuster at (212) 701-3323 or jschuster@cahill.com; Arthur Dobelis at (212) 701-3359 or adobelis@cahill.com; or Boji Wong at (212) 701-3011 or bwong@cahill.com.