607 Executive Compensation Disclosures & Arrangements

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Faculty Biographies

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Michael D. Cahn

Michael D. Cahn is senior associate general counsel – securities at Textron Inc. in Providence, Rhode Island. He advises Textron on issuances of securities, disclosure issues, SEC reporting and corporate governance issues. He also advises Textron on corporate development and other legal matters.

Prior to joining Textron, Mr. Cahn was an associate at Cahill Gordon & Reindel in New York City.

Mr. Cahn is a member of ACC's BOD. He was Chair of ACC's Corporate and Securities Law Committee and served as chair of ACC's Council of Committees. He also has served on the Advisory Board of the ACC Docket and is a frequent lecturer and panelist at corporate and securities law seminars.

Mr. Cahn received a BA from Michigan State University and his JD from Harvard Law School.

Ronald O. Mueller

Ronald O. Mueller is a partner in the Washington, D.C. office of Gibson, Dunn & Crutcher. Mr. Mueller works in the corporate and securities area with an emphasis on proxy and disclosure issues, corporate governance, executive compensation (including Section 16 and Rule 144) and corporate transactions.

From September 1989 to June 1991, Mr. Mueller separated from the firm to work as legal counsel to Commissioner Edward H. Fleischman at the United States Securities & Exchange Commission (SEC). While at the SEC, Mr. Mueller worked on many of the matters before the Commission, including enforcement matters and regulatory initiatives.

Mr. Mueller has written articles and spoken at seminars about a variety of securities law issues, including trends and developments in proxy disclosures and proxy contests, the SEC's disclosure requirements, corporate governance developments, and executive compensation disclosure rules. Mr. Mueller is a contributing author to A Practical Guide to Section 16, Aspen Law & Business; A Practical Guide to SEC Proxy and Compensation Rules, Aspen Law & Business; and Federal Securities Exchange Act of 1934, Insider Reporting and Short-Swing Trading, Matthew Bender.

Mr. Mueller his B.A., magna cum laude, from Vanderbilt University, and received his J.D. from Columbia Law School, where he was both a Harlan Fisk Stone Scholar and a James Kent Scholar.

Craig Nordlund
Senior Vice President, General Counsel & Secretary
Agilent Technologies, Inc.

The SEC's New Executive Compensation Disclosure Rules

ACC 2006 Annual Meeting
October 23-25, 2006
Ronald O. Mueller

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Effective Dates

- Compensation rules effective for fiscal years ending on or after December 15, 2006 (will apply to disclosures of 2006 compensation in the 2007 proxy statement). Early compliance is permitted
- 8-K rules effective on November 7, 2006, 60 days following rule publication in the Federal Register.

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Compensation Discussion & Analysis

- Discuss the compensation awarded to, earned by, or paid to the named executive officers. The discussion shall explain all material elements of the registrant's compensation of the named executive officers. The discussion shall describe the following:

i. The objectives of the registrant's compensation programs;
ii. What the compensation program is designed to reward;
iii. Each element of compensation;
iv. Why the registrant chooses to pay each element;
v. How the registrant determines the amount (and, where applicable, the formula) for each element; and
vi. How each compensation element and the registrant's decisions regarding that element fit into the registrant's overall compensation objectives and affect decisions regarding other elements of compensation.

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Compensation Discussion & Analysis
(differences from Compensation Committee Report)

Bd Comp Comm Report (old)	Comp Discussion & Analysis
• Compensation for executives generally	• Compensation awarded to, earned by or paid to the NEOs
• Specific relationship of corporate performance to executive compensation	• The objectives, elements, goals and operation of compensation
• Specific discussion of relationship between company's performance and CEO's compensation	• Specific discussion of bases of compensation of each of the NEOs

Examples of Topics to Cover in the CD&A

(i) The policies for allocating between long-term and currently paid out compensation;

(ii) The policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation;

(iii) For long-term compensation, the basis for allocating compensation to each different form of award (such as relationship of the award to the achievement of the registrant's long-term goals, management's exposure to downside equity performance risk, correlation between cost to registrant and expected benefits to the registrant);

(iv) How the determination is made as to when awards are granted, including awards of equity-based compensation such as options;

(v) What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions;

(vi) How specific forms of compensation are structured and implemented to reflect these items of the registrant's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal(s) or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified named executive officers or to all compensation subject to the relevant performance goal(s);

(vii) How specific forms of compensation are structured and implemented to reflect the named executive officer's individual performance and/or individual contribution to these items of the registrant's performance, describing the elements of individual performance and/or contribution that are taken into account;

(viii) Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;

(ix) The factors considered in decisions to increase or decrease compensation materially;

(x) How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g. , how gains from prior option or stock awards are considered in setting retirement benefits);

(xi) With respect to any contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) at, following, or in connection with any termination or change-in-control, the basis for selecting particular events as triggering payment (e.g., the rationale for providing a single trigger for payment in the event of a change-in-control);

(xii) The impact of the accounting and tax treatments of the particular form of compensation;

(xiii) The registrant's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership), and any registrant policies regarding hedging the economic risk of such ownership;

(xiv) Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies); and

(xv) The role of executive officers in determining executive compensation.

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Compensation Discussion & Analysis

The CD&A is company disclosure that is "filed":

- covered by the PEO's and PFO's certifications;
- executives may "look to" the Compensation Committee Report;

New Compensation Committee Report "furnished" with proxy and Form 10-K, appears over committee members' names and must state:

- whether the compensation committee has reviewed and discussed the CD&A with management; and
- whether, based on that review and discussion, the committee recommended to the board that the CD&A be included in the proxy statement and Form 10-K.

Named Executive Officers

The "named executive officers" for whom disclosure is required under the new rules are:

- any person who served during the last fiscal year as the principal executive officer;
- any person who served during the last fiscal year as the principal financial officer;
- three most highly compensated executive officers, other than the principal executive officer and the principal financial officer, who were serving as executives at the end of the last fiscal year; and
- up to two additional persons who served as executive officers during, but not at the end of, the fiscal year, whose "total compensation" is higher than that of any of the three other most highly compensated executive officers described above.

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Summary Compensation Table

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

- Three fiscal year disclosure but phased in. Proxy statement in 2007 would report only one year – 2006

Summary Compensation Table

- “Bonus” vs. Other Columns – does away with “annual” vs. “long-term” distinction
- 162(m) bonuses likely treated as Non-Equity Incentive Plan Compensation rather than Bonuses
  - Outcome with respect to performance targets substantially uncertain when established
  - Target communicated to executive
- Full grant date fair value ($) listed
  - Stock awards – restricted stock, restricted stock units & other awards “within the scope of” SFAS 123(R)
  - Option awards – options, stock appreciation rights

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Summary Compensation Table

- Incremental FAS 123R fair value recognized for repriced or otherwise materially modified options
- Non-equity incentive - $ earned rather than grant or payment amount
- Deferred amounts reported in appropriate column assuming no deferral (and then don't need to be reflected when paid); Salary or bonus electively converted to stock or other non-cash compensation, generally reported in appropriate column
- All values in $ (Conversion methodology for foreign currency in footnote)
- Narrative disclosure of material terms

Summary Compensation Table All Other Compensation Column

Name	Perquisites ($)	Tax Reimbursements ($)	Insurance Premiums ($)	Company Contributions to DC Plans ($)	Severance Payments/Accruals ($)	Change in Control Payments/ Accruals ($)
NEOs						

- Any item, other than perquisites, that is >$10,000 must be separately identified and quantified unless reported elsewhere or specifically excluded from disclosure
- If perquisites are valued in the aggregate at $10,000 or more, each perquisite must be separately named

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Summary Compensation Table

Perquisites

- Two part test:
  - Not a perquisite if integrally & directly related to performance of duties
  - Does it confer a direct or indirect benefit that has a personal aspect and is not generally available to all employees on a non-discriminatory basis
- If perquisites are valued in the aggregate at $10,000 or more, each perquisite must be separately identified
- Any perquisite or other personal benefit must be separately quantified if it is valued at greater than $25,000 or 10% of total perquisites and other personal benefits
- Perquisites valued on aggregate incremental cost standard and the methodology must be described

Grants of Plan-Based Awards Table

Grant of Plan- Based Awards in Fiscal Year 200x

			Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Non-Equity Rights (#)	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 Under-lying Options (#)	Exercise or Base Price of Option Awards ($/Sh)	Market Price on Grant Date ($)
Name	Grant Date	Approval Date	Threshold ($)	Target ($)	Maximum ($)		Threshold (#)	Target (#)	Maximum (#)				
(a)	(b)		(c)	(d)	(e)		(f)	(g)	(h)	(i)	(j)	(k)	
NEOs													

- Separate disclosure for each grant
- Includes annual and long-term awards
- Extra "Approval Date" column if different than grant date & extra "Market Price" column and description of methodology if exercise price is less than closing price

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Options Disclosure

- CD&A must answer questions such as these:
  - How is timing of option grant determined?
  - How is exercise price determined?
  - How does the presence of material inside information affect option grant practices?
- Tabular disclosure
  - Grant date fair value disclosure in Summary Compensation Statement
  - Extra columns in "Grants of Plan-Based Awards" Table.
    - If grant date is different from date of corporate action
    - If exercise price is less than closing stock price on grant date (Then must also describe method for determining exercise price.)

Outstanding Equity Awards at Fiscal Year End Table

Outstanding Equity Awards at 200x Fiscal Year End

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Options (#) Exercisable	Number of Securities Underlying Unexercised Options(#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number 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)
NEOs									

- **Grant by grant reporting for options and aggregate disclosure for other awards**
- **Vesting dates must be disclosed in footnote**
- **Unearned awards disclosed based on threshold performance goals in first year and next highest performance level (threshold, target or maximum) from actual results for subsequent years**

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Option Exercises and Stock Vested Table

Option Exercises and Stock Vested in Fiscal Year 200x

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

- Report actual amounts earned
- Footnote to disclose any amounts deferred

Pension Benefits Table

Pension Benefits for the 200x Fiscal Year

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

- Use same pension measurement date used to prepare audited annual financials for last completed fiscal year and generally use same assumptions as used to prepare financials
- Includes benefits under tax-qualified defined benefit plans
- Separate row for each plan

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Pension Benefits Table

- Data for last completed fiscal year only.
- Narrative disclosure must include:
  - Valuation method and all material assumptions (can refer to financial statement footnotes, MD&A to avoid repetition).
  - Material terms of plan, such as elements of compensation used in calculating benefits, benefit formula and basic form of payment

Nonqualified Deferred Compensation Table

Nonqualified Deferred Compensation for the 200x Fiscal Year

Name (a)	Executive Contributions in last fiscal year ($) (b)	Registrant Contributions in last fiscal year ($) (c)	Aggregate Earnings in last fiscal year ($) (d)	Aggregate Withdrawals/ Distributions ($) (e)	Aggregate Balance at last fiscal year end ($) (f)
NEOs					

- Doesn't include tax-qualified retirement plans (e.g. 401(k) plan benefits)
- Provide footnote regarding amounts disclosed in other tables to avoid double counting
- Narrative description of material aspects of plan

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Termination/Change in Control Payments

- Table not required; can be only narrative disclosure
- Narrative disclosure must include:
  - List of each triggering event (likely to be multiple types of termination triggering severance benefits).
  - For **each** triggering event, description and quantification of estimated benefits. Assume event occurred at end of last completed fiscal year at year-end stock price.
  - Description of post-employment conditions on payment (e.g. non-compete, non-solicitation).
  - Non-discriminatory benefits need not be disclosed (e.g., generally provided death benefits).

Director Compensation Table

Director Compensation in Fiscal 200x

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

- Each director on a separate row unless all elements/amounts identical
- Footnote disclosure of aggregate number of stock awards and aggregate number of option awards outstanding at fiscal year end
- All Other Compensation includes perquisites, consulting fees and costs of charitable award programs
- Narrative description of material factors necessary to understanding compensation disclosed in table

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Compensation-Related 8-K Disclosure

- Executive plans, contracts or arrangements, grants or agreements entered into, adopted or made are disclosed in Item 5.02(e) rather than in Item 1.01
- Exhibit standard of Item 601(b)(10)(iii) remains as is but is no longer the Form 8-K standard
- Item 5.02(e) requires brief description of terms and amounts payable:
  - Only if made to or participants include NEO or principal executive of financial officer
  - Not necessary to describe material grant or award if "materially consistent with previously disclosed terms" and award is disclosed when 402 requires such disclosure
  - Director compensation covered only when first elected; other executives not covered

Compensation-Related 8-K Disclosure

- NEO for Item 5.02 purposes determined by most recent Item 402(c) disclosure (generally proxy statement)
- New 8-K disclosure item:
  - NEOs added to list of Item 5.02(b) events that are triggered upon retirement, resignation or termination (continues to apply to directors and PEO, President, PFO, PAO and POO)
- Item 5.02(c) disclosure for appointments of principal officers (and non-shareholder approved directors) expanded to require description of any plans and arrangements and grants or awards made or modified in connection with event

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Compensation-Related 8-K Disclosure

- Salary or bonus omitted from Summary Compensation Table because not yet known will require 8-K disclosure (including new total compensation figure) when calculable
- Section 10(b), Rule 10b-5 and S-3 eligibility safe harbors extended to Item 5.02(e)

New Item 407(e) Disclosure on Compensation Committee Operations

- Narrative description of processes and procedures for consideration and determination of executive and director compensation, including:
  - Extent to which the Comp Committee may delegate;
  - Any role of executive officers in determining or recommending the amount or form of executive or director compensation; and
  - Any role of compensation consultants, identifying them, and describing nature and scope of their assignment.

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New Related Party Transactions Disclosure

- Item 404(a) related party transaction disclosure emphasized as a more principles-based standard:
  - threshold for consideration of transactions is $120,000
  - some instructions on relationships that can be omitted are deleted
  - transactions with companies where directors serve as executives now evaluated under this standard; old 404(b) deleted
- New Item 404(b) requires description of policies and procedures for review, approval or ratification of any 404(a) transactions.
  - who is responsible for applying the policies; and
  - whether any reported transactions were not reviewed and approved or ratified.

New Corporate Governance Disclosures

- Old Item 404(b) deleted:
  - formerly set 5% thresholds for disclosure of dealings with companies where directors served as executives, etc.
- Need to disclose director independence status using NYSE/NASDAQ listing standards
- For each director listed as being independent, describe "by specific category or type" any relationships not disclosed under Item 404(a) that were considered when assessing independence.
- Other governance standards consolidated into new Item 407.

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Steps You Should Take to Prepare Now

- Prepare mock-up of tables
  - To identify interpretive questions
  - To determine who will perform calculations
  - Will aid in drafting CD&A
- Review financial statement assumptions that will carry over into proxy statement disclosures
- Identify events & arrangements subject to change-in-control and termination disclosures
- Review standards for identifying, approving or ratifying related party transactions
- Review disclosure controls around proxy reporting

GIBSON, DUNN & CRUTCHER LLP

September 6, 2006

M E M O R A N D U M

TO: Our Clients

FROM: Ronald O. Mueller

RE: Background on Stock Option Grant Practices

This memorandum provides an overview of issues being raised in the current controversy over option grant date practices.

I. Introduction

In recent months, option grant practices have come under heightened scrutiny over allegations that executives have been manipulating the dates of their option grants in order to increase their value. Beginning in the late 1990s, academics studying option grants reported that grants to CEOs and other executives tended to occur on days when company stock prices were unusually low. In November 2004, the SEC began investigating option grant practices at several technology companies. At that time, the director of the SEC's Division of Enforcement publicly stated that he believed that it was problematic, and perhaps illegal, for a company to grant options at a time when the company was aware of material non-public information. While the SEC's investigations of option grant practices at a number of companies has been on-going for more than a year, interest in companies' option practices exploded following a March 18, 2006 article by the Wall Street Journal focusing on grant practices at six companies. Currently, more than 100 public companies have disclosed criminal, regulatory or internal investigations into their option grant practices.

II. Problematic Option Grant Practices

A core issue for most, but not all, option grant practices that are being reviewed arises from the issue of when exactly an option "grant" is deemed to occur. The issue arises because an option's exercise price is typically derived from the stock's price on the date the option is granted, and because the date of grant can have accounting, tax, securities law and corporate law implications. Most companies that to date have announced problematic option grant practices have not specifically identified the nature of the practices. Generally, though, the issues being addressed include the following:

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A. Intentional Backdating

Intentional backdating occurs when an option's grant date, or the date that otherwise is used to set the option's exercise price, is recorded as occurring in the past; typically as of a date when the company's stock price (and thus the option's exercise price) was lower.

B. Unintentional Backdating or "Misdating"

Option grants may be unintentionally backdated or "misdated" as a consequence of corporate actions and policies that result in an option's grant date being recorded as occurring on a date that is different than (and typically earlier than) when it is deemed to have been granted under an applicable accounting or legal standard. This may arise in a variety of circumstances. For example, companies may recorded options as being granted on the date that a written consent authorizing the grants was sent to its directors, whereas under some states' corporate law or under accounting or tax standards, the grant date may not be deemed to occur until the date that every signature was obtained on the written consent. For example, Affiliated Computer Services disclosed in an SEC filing on May 10, 2006 that its Compensation Committee had inadvertently backdated options by using as the award date for a grant the date specified in the written consent approving the grant, which generally preceded the date on which all members of the Committee had signed the consent.

Option grant practices that were reported to have occurred at Microsoft may be viewed as a form of misdating. Under those practices, options would be deemed to be granted on the date that the stock hit its lowest price during the month. Because the date with the lowest price could not be determined until the end of the month, the issue arose as to whether for accounting purposes the options were not deemed granted until the end of the month.

C. Inadequate Grant Date Documentation

The focus on substantiating option grant dates has revealed that some companies do not possess adequate documentation to substantiate the date the options were granted. A common scenario occurs where a senior executive (typically the CEO or head of HR) has been delegated authority to grant options under a stock plan, and there is no concurrent documentation to demonstrate when a particular option was granted. For example, the CEO may have orally stated that an option was to be granted, but there is no concurrent email or other documentation of that authorization, and the grant agreement or notification may not have been completed and distributed until the end of the month. In other cases, grants may have been concurrently documented, but the authority of the person who made the grant is not properly documented.

D. Spring-loading

"Spring-loading" refers to a practice in which a company sets the grant date and exercise price of an option just prior to the release of material nonpublic information that is expected to increase the company's stock price. For example, Cyberonics is being investigated by the SEC and the U.S. Attorney's Office for the Southern District of New York in connection with a option grant made by the company on the day that an FDA advisory panel recommended approval of one of the company's medical devices. The day following the stock grant, the price of the company's stock rose 78 percent.

E. Other Practices

A variety of other practices have been uncovered in the course of option grant practice reviews. At Mercury Interactive, the company has stated that an internal review indicates that, among other problematic practices, certain employees backdated exercise dates for options. This practice had the effect of reducing the amount reportable by the optionee as taxable income upon exercise and establishing an earlier capital gains holding period. The company also reported that it allowed employees to pay for option exercises with promissory notes that were not enforced. CA, Inc. (formerly known as Computer Associates) announced that it "experienced delays of as much as two years from the date that employee options were approved by the Company's Board of Directors to the date such option grants were communicated to individual employees."

III. Implications of Problematic Option Grant Practices

Granting options with an exercise price that is below the fair market value of the stock on the date of grant is not in itself illegal. However, the practices described above can have accounting, tax, securities law and corporate law implications.

A. Accounting Issues

Under former accounting rules (APB 25, which was in effect prior to companies' implementation of FAS 123R), companies were required to record an accounting expense from the grant of an option if the option's exercise price was below the stock's market price on the "measurement date." The accounting literature did not define how to establish a company's market price (companies generally used the average of the high and low, the average of the open and the closing price or the closing price). The "measurement date" was generally viewed as being the date that the number of shares subject to the option and the option exercise price were fixed. If an option's exercise price is below the stock's market price on the measurement date – which could occur because of intentional backdating or unintentional misdating – accounting rules require the company to record the difference as an expense, which is recognized over the vesting term of the option. As a result of the typical multi-year vesting terms applicable to options, the accounting implications of backdated options thus can impact the accuracy of financial statements for a number of years following the options' grant. While the accounting standards applicable under APB 25 appear to be unclear, some commenters have suggested that the absence of valid authorizations for, or delays in documentation of, option grants may result in a measurement date that could differ from the reported grant date.

B. Tax Issues

Tax rules applicable to incentive stock options define the "date of grant" as occurring "when the granting corporation completes the corporate action constituting an offer of stock for sale to an individual under the terms and conditions of a statutory option. A corporate action constituting an offer of stock for sale is not considered complete until the date on which the maximum number of shares that can be purchased under the option and the minimum option price are fixed or determinable." It is likely the IRS will apply this same definition for all purposes under the tax laws.

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In order for a company to be entitled to deduct the "spread" on options that are exercised by the company's CEO and four next most highly compensated executive officers, the option must qualify as "performance-based compensation" under Section 162(m) of the Internal Revenue Code. The most common basis relied upon for an option to qualify as "performance-based compensation" is for the option to have an exercise price equal to the stock's fair market value on the date the option was granted. Thus, if an option's exercise price is below the stock's fair market value on the grant date – which could occur because of intentional backdating or unintentional misdating – then years later, if the optionee is subject to Section 162(m) at the time the option is exercised, the company may not be entitled to deduct the entire spread realized by the optionee upon exercise of the option. If such an option has already been exercised and the company has already claimed a deduction for it, the company may need to refile its income tax returns. For companies that are not current taxpayers due to net operating losses, the loss of a deduction affects how quickly they use up their net operating losses.

In addition, there can be adverse tax consequences for optionees if they are granted options with an exercise price below the stock's fair market value on the date the option is deemed to have been granted for tax purposes. Subject to certain transition rules, these options are treated as giving rise to deferred compensation under new Section 409A of the Internal Revenue Code to the extent they first become exercisable after December 31, 2004. Under Section 409A, the spread on an option that was granted with a below fair market value exercise price is taxable to the optionee once the option vests, whether or not it is exercised at that time. The optionee also is subject to additional excise taxes imposed upon deferred compensation under Section 409A. Finally, if an option's exercise price is below the stock's fair market value on the date the option was granted, the option can not qualify for favorable tax treatment as an "incentive stock option" (also known as an ISO).

C. Securities Law Issues

The main securities law implications of inappropriate option grant practices are derivative from the accounting and tax consequences; if a company has not properly accounted for grants of options or for the tax treatment of option exercises, then financial statements included in its SEC filings may be inaccurate and, if material, require restatement. However, there are other potential collateral implications. The grant practices may result in a violation of the "books and records" provision of the securities law, which require companies to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions … of the issuer" and to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles." In addition, the practices may not be consistent with statements that have been made in companies' proxy statements and other filings, such as statements that all options are granted with an exercise price equal to the fair market value on the date of grant (proxy disclosure rules require that the chart reporting option grants to executive officers reflect whether the options have an exercise price that is below the grant date stock price) and statements that options are deductible under Section 162(m). For more recent years, the practices may indicate a deficiency in companies' internal controls over financial reporting and thus affect the company's ability to provide internal control certifications.

Spring-loading poses different securities law issues than the other practices, primarily relating to whether the practice constitutes a form of illegal insider trading. In this regard, the traditional view has been that it does not constitute insider trading when directors who are aware of material nonpublic information authorize the grant of options, since there is no deception when they are fully informed of the inside information. Nevertheless, as noted above, the SEC's enforcement division has been pursuing cases that may test the limits of insider trading theory by asserting that spring-loading is unlawful. One company, Analog Devices, has announced that it agreed to settle an SEC investigation into the practice rather than litigate over the issue.

D. Corporate Law Issues

Option grant practices can raise corporate law concerns as to whether particular options were duly authorized, either because they were granted under an equity compensation plan (typically, a plan approved by stockholders) that requires options to have an exercise price equal to the stock's market price on the date of grant, or because the person purporting to make grants was not at the time authorized to do so (or the authorization was not appropriately documented and can not be demonstrated). These situations can raise difficult questions as to whether outstanding options are valid obligations of the company and, if a company seeks to ratify past grants, whether the "ratification" is effectively a new grant that requires a new option exercise price.

IV. Other Developments

The controversies over option grant practices have lead to a number of other developments:

- Most companies have undertaken at least an internal review of their past option grant practices to determine the extent to which they can document the timing and authorization of option grants. While it is not yet clear what procedures audit firms may implement in reviewing clients' past accounting for options, it appears that some of the firms have developed a list of clients that are viewed as having possibly problematic practices. On July 28, 2006, the Public Company Accounting Oversight Board issued an Audit Practice Alert Regarding Timing and Accounting for Stock Option Grant. The alert provides guidance on auditor reviews of accounting for option grants.

- Many investment analysts have sought to identify companies that may be at risk of having questionable option grant practices and have advised their clients that investments in such companies may be at risk if an option accounting scandal results in financial restatements or termination of key executives who participated in the practices. There are reports that hedge funds have used the threat of an option accounting rumor as a basis for trying to extract some form of concession from companies. Companies often have not been able to respond to such allegations, either because they are in the process of conducting internal reviews of the option grant practices, or because of Regulation FD concerns over privately discussing the status of such internal reviews.

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- SEC and Department of Justice investigations and civil securities class-action lawsuits have been commenced against many companies, often based solely on a news or analyst report suggesting that the company's option grant practices appear suspect.

- The SEC's new rules on executive compensation disclosure, released on August 11, 2006, include expanded disclosures about stock options:
  - Companies must address matters relating to executives' option compensation in the new Compensation Discussion and Analysis section, including the timing of grants and how exercise prices are determined.
  - Grants of stock options must be disclosed in the Summary Compensation Table at their fair value on the date of grant, as determined under FAS 123R.
  - The grant date of option awards must be disclosed in a new "Grants of Plan-Based Awards" table.

- A number of institutional investors have used the controversy over option backdating as a further basis for criticizing executive compensation. It can be expected that the issue will remain a source of discussion and rhetoric for the coming proxy season. A number of institutional investors have written companies asking them to take a number of steps to address perceived option grant abuses. For example, the California Public Employees Retirement System (CalPERS) urged directors at certain companies to:
  - Conduct an independent investigation into backdating allegations.
  - Publicly disclose all findings from both internal and external investigations.
  - Develop and disclose in public financial statements and proxy statements a new board policy for the determination of all option grant dates.
  - Refrain from using any company resources to satisfy the tax and legal liability for executives implicated for wrongdoing related to the backdating of options.
  - Commit to have the company's selection of its external auditor ratified by shareowners annually.

- As institutional investors press companies to overhaul their option grant policies, Institutional Shareholder Services recommends the following best practices for shareholders and boards to consider:
  - Adopt "blackout" periods to preclude stock grants when company executives have material, non-public information in hand.
  - Adopt fixed grant date schedules that provide for grants on a periodic basis (monthly, quarterly, or annually), along with rules for the establishment of option exercise prices on such grant dates.
  - Refrain from making grants on these fixed dates when executives have market-moving news.
  - Disclose the rationale for grants on a certain date, explaining why the compensation committee chose that date over other possible dates.
  - File Form 4 reports on option grants promptly with the SEC, since the failure to file these reports within the required two business days may suggest documentation problems.

September 1, 2006

AN OVERVIEW OF AND PRACTICAL GUIDANCE ON THE SEC'S NEW RULES AMENDING EXECUTIVE COMPENSATION, RELATED PARTY, GOVERNANCE AND FORM 8-K DISCLOSURE REQUIREMENTS

To Our Clients and Friends:

The Securities and Exchange Commission ("SEC") has issued its new rules comprehensively revising the disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters. The final rules also modify the requirements for disclosing executive compensation actions and arrangements on Form 8-K. With a few notable exceptions, the final rules as adopted are substantially similar to the SEC's proposal from January 2006.

The new rules will be effective for fiscal years ending on or after December 15, 2006, and therefore apply to disclosures of 2006 compensation in calendar-year companies' 2007 proxy statements. The new rules applicable to disclosure of executive compensation arrangements on Form 8-K become effective in early November 2006, 60 days after the new rules are published in the Federal Register, applying to executive compensation events that occur on or after that date.

This Client Alert is intended to provide an initial detailed review of the new disclosure rules and compensation tables required under them. We highlight a number of areas where these new rules require careful attention or raise significant interpretive issues, and throughout this Client Alert we note actions that companies should be taking now to prepare for the new rules. Given the comprehensive nature of the rule revisions, we expect that additional interpretive issues will arise and that the SEC staff will provide its views on these issues. Nevertheless, companies should begin to prepare their disclosures well in advance of filing their proxy statement.

Among the significant aspects of the rule changes that require companies' attention now are the following:

- The SEC adopted the new requirement for a Compensation Disclosure and Analysis ("CD&A"). The CD&A is intended to differ significantly from the former Board Compensation Committee Report on Executive Compensation by comprehensively addressing the design and bases for a company's compensation of each of its named executive officers. The CD&A will need to describe the operation and material features of each element of named executive officer compensation and the interaction of each of those elements (or lack of interaction) with one another. The CD&A is company disclosure that is covered by the chief executive officer's and chief financial officer's certifications; yet, the board's compensation committee will need to remain closely involved in the preparation and review of this disclosure. We expect that most companies will not be able to use the Board Compensation Committee Report as a model for drafting the CD&A and that the CD&A drafting process will necessitate extensive and careful coordination between the human resources and legal departments with the input of the board's compensation committee. Companies will need to determine who

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are their named executive officers and will need to prepare drafts of the tabular and narrative compensation disclosures required under the rules in order to be best positioned to draft the CD&A.

- The characterization, presentation and calculation of some forms of compensation differ significantly from the present rules and are not always intuitive. For example, some annual bonuses will no longer be reported in the Bonus column of the Summary Compensation Table but instead will be reported as Stock Awards or as Non-Equity Incentive Plan Compensation. Careful review is necessary to determine how and where to report various forms of compensation.

- It may be necessary to retain outside actuaries and consultants to perform some of the calculations required under the new rules. Companies should make arrangements with those outside advisers now.

- Careful descriptions and calculations of benefits payable under severance and change of control arrangements will be necessary. Companies should begin now to identify each form of benefit and triggering event encompassed by this disclosure requirement and to determine whether any of these arrangements should be revised before the end of their fiscal year. Given the extensive disclosure that will be required at some companies, companies should begin now to evaluate how to most clearly present the required benefit amounts and narrative descriptions.

- Revised related party and director independence disclosure rules reinforce the need to have procedures in place to monitor on a current basis transactions between a company and its directors, executives and immediate family members of directors and executives. Companies that do not have written procedures for identifying and approving or ratifying related party transactions should consider adopting them. Companies also need to revise their director and officer questionnaires.

- Amendments to Form 8-K generally reduce the number of executive compensation related events that trigger Form 8-K filings and eliminate the need for Form 8-K reports on most director compensation related matters, but there are also some new Form 8-K triggering events that will go into effect in the near future. Companies should revise their disclosure controls to ensure that reportable events are timely identified.

Compensation Discussion & Analysis

The new rules delete the current requirement for a Board Compensation Committee Report on Executive Compensation and require instead a Compensation Discussion & Analysis ("CD&A"). SEC officials have emphasized that the CD&A is intended to provide a dramatically different perspective on executive compensation than the existing Board Compensation Committee Report. The CD&A is intended to provide an overview of material aspects of the objectives, implementation and factors underlying named executive officers' compensation overall as well as information on the operation of each material element of compensation. The discussion is required to describe the following:

(i) The objectives of the company's compensation programs;
(ii) What the company's compensation program is designed to reward;
(iii) Each element of compensation;
(iv) Why the company chooses to pay each element;
(v) How the company determines the amount (and, where applicable, the formula) for each element to pay; and
(vi) How each compensation element and the company's decisions regarding that element fit into the company's overall compensation objectives and affect decisions regarding other elements.

The rules list fifteen examples of topics that, to the extent applicable and material, may need to be addressed in the CD&A. These examples, which are listed in Exhibit A to this Client Alert, together with an understanding of the types of comments that the SEC staff issues on Management's Discussion and Analysis of Financial Condition and Operating Results, provide helpful insight into the comprehensive and detailed level of discussion that the SEC expects in the CD&A. However, as a principles-based disclosure regime, CD&A disclosures should not be drafted as simply responses to these questions, nor should the CD&A be limited to the topics listed in the examples if there are other material factors that have affected a company's compensation of its named executive officers. Instead, the CD&A should explain and place in context the compensation disclosures in the proxy statement, encompassing the topics covered in the rule's examples to the extent material. Unlike the current Board Compensation Committee Report, the CD&A should specifically address the compensation of each of the named executive officers and be sufficiently precise to identify material differences in compensation policies and decisions among them, but the named executive officers' compensation can be discussed as a group where the policies and decisions affecting their compensation are materially similar.

As is also the case currently, the rules do not require companies to disclose target levels of specific quantitative or qualitative performance-related factors considered by the board's compensation committee or any other factors or criteria involving confidential trade secrets or confidential commercial or financial information, if disclosure of those factors or criteria would result in competitive harm for the company. However, if a company relies on this exception, the CD&A must discuss how difficult or likely achieving the factor or criteria is believed to be. SEC officials have stated that they intend to review and comment on the CD&A to enforce this standard of disclosure.

The CD&A is disclosure by the company – not by the board's compensation committee – that is "filed" rather than "furnished," and thus is subject to certification by a company's principal executive officer and principal financial officer. Accordingly, companies' disclosure controls should be sufficient to ensure that the CD&A accurately sets forth all required information. Likewise, before a company files its proxy statement, there should be a disclosure committee review that encompasses not only the tabular compensation and related party disclosures in the proxy but also the CD&A.

In addition to the CD&A, companies are required to furnish a compensation committee report that is similar to the audit committee report currently required in proxy statements. This new report of the board's compensation committee consists of a brief statement on whether the compensation committee reviewed and discussed the CD&A with management and, based on

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that review and discussion, whether the committee recommended to the company's board of directors that the CD&A be included in the company's proxy statement and annual report on Form 10-K. To the extent that board compensation committees wish to express their views or philosophy on the company's executive compensation, those statements may be included in the report by the compensation committee.

Determination of the Named Executive Officers

The "named executive officers" ("NEOs") for whom compensation disclosure is required under the new rules are:

- any person who served during the year as the principal executive officer;
- any person who served during the year as the principal financial officer;
- three other most highly compensated executive officers, other than the principal executive officer and the principal financial officer, who were serving as executive officers at the end of the fiscal year; and
- up to two additional persons who served as executive officers during, but not at the end of, the fiscal year, whose "total compensation" is higher than that of any of the three other most highly compensated executive officers described above.

To determine who are the most highly compensated executives, companies total the amounts reportable for the year under each column of the Summary Compensation Table for each executive, other than amounts that would be reported as above-market earnings on deferred compensation and the actuarial increase in pension benefit accruals. Significantly, large severance payments to departing executives may cause them to be NEOs in the year they cease to be employed with a company because amounts that were paid or accrued in connection with a termination of employment during the fiscal year generally are counted in determining whether a former executive's "total compensation" is higher than that of any of the three most highly compensated executive officers were serving at the end of the fiscal year.

This new definition of NEO can significantly affect companies' planning strategies for complying with the provisions for deductibility of compensation in excess of $1 million under Section 162(m) of the Tax Code. This is because Section 162(m) applies to the principal executive officer and the four individuals who were serving as executives at year-end who were the highest paid executive officers (other than the principal executive officer) determined pursuant to the SEC's executive compensation disclosure rules. Companies that arranged Section 162(m) compliance for 2006 based on who they expected to have the highest salaries and bonuses may discover that their highest paid executive officers differ for proxy disclosure and Section 162(m) compliance purposes. Moreover, in the event that the principal financial officer (who now is treated as an NEO for proxy disclosure purposes regardless of compensation levels) is not one of the four highest paid executive officers (other than the principal executive officer), compensation paid to an individual who does not appear as a named executive officer in the proxy statement may be subject to Section 162(m).

Revised Executive Compensation Tables

The new rules require most companies to set forth six tables disclosing various aspects of NEO compensation. As under the current rules, companies can omit columns to the extent they are not applicable.

Phase-In of New Disclosures; No Pre-2006 Disclosure

Eventually, the Summary Compensation Table will require disclosure of compensation in each of the three most recent fiscal years, as is currently the case under the existing rules. However, the new Summary Compensation Table disclosures "phase-in" over the next three years: in the first year, only fiscal year 2006 disclosure is required. Thus, companies will not be required to recalculate or report compensation for fiscal years that were covered in previously filed proxy statements.

Summary Compensation Table

The Summary Compensation Table reports amounts paid during the fiscal year, equity awards that were granted during the year and other benefits that accrued during the fiscal year, together with a Total column that sums all of these disparate elements.

Summary Compensation Table

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

- Amounts of compensation are to be reported in the applicable column, even if some of the compensation was deferred.
- Cash payments are reported in the Bonus column only if they were paid under an arrangement that either (i) did not involve pre-established performance criteria that were communicated to the executive, or (ii) was not "substantially uncertain." Thus, a payment that is based on an end-of-year assessment of performance or a payment that is guaranteed under an employment agreement is reported in the Bonus column. In contrast, annual cash payments based on performance criteria that are "substantially uncertain" at the time established (a term that applies under the Tax Code for awards intended to qualify as "performance-based" under Section 162(m)) and that are communicated to executives in advance are reported in the Non-Equity Incentive Plan Compensation column.
- The Stock Awards and Option Awards columns report a dollar value equal to the grant date fair value computed under Statement of Financial Accounting Standards No. 123

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(revised), Share-Based Payment ("SFAS 123(R)"). In calculating the value of these awards, a company must use the same assumptions that it applies for financial statement reporting purposes. Additional details about awards shown in these columns are presented in the Grants of Plan-Based Awards Table in the same year they are reported in the Summary Compensation Table.

- If a company has adjusted or amended the exercise price of options or stock appreciation rights ("SARs") or otherwise materially modified outstanding options or SARs, the incremental fair value of the amended award must be included in the Option Awards column.

- An annual or long-term award or arrangement that is payable in company stock (even if denominated in dollars or payable in cash or stock at the company's or participant's election) is treated as an equity-based incentive plan award because these types of arrangements are typically subject to SFAS 123(R). Therefore, this type of award or arrangement is reported in the Stock Awards column at grant, based on its grant date value.

- Dividends and dividend equivalents on stock and option awards are not reported in the Summary Compensation Table (or elsewhere) if the value of expected dividends was taken into account in calculating the SFAS 123(R) grant date fair value of those awards.

- Amounts that have been earned based upon performance under a Non-Equity Incentive Compensation Plan are reported in the Summary Compensation Table when the performance conditions are satisfied, even if amounts are deferred or remain subject to a continued service vesting condition. These amounts are not thereafter reported when actually paid.

- Amounts are reported as Earnings on Non-Qualified Deferred Compensation in the Summary Compensation Table only if they are "above-market" earnings, as defined in the rules.

- When calculating the annual increase in an NEO's pension benefits for purposes of determining the amount reported in the Change in Pension Value column, companies must apply the same actuarial and other assumptions used for financial statement reporting purposes. The amount reported ties to the year-over-year difference of the amounts required to be reported in the new Pension Benefits Table discussed below. The Change in Pension Value column must show zero if the amounts otherwise would be negative.

- The Summary Compensation Table is to be accompanied by extensive footnote disclosure of matters such as the assumptions used in valuing stock awards and option awards.

Narrative disclosure accompanying the Summary Compensation Table and the Grant of Plan-Based Awards Table (which is discussed below) must describe any material information necessary for understanding the information in these tables. This narrative should provide a specific context to the quantitative disclosure in these tables, explaining, for example:

- the relationship between amounts disclosed and any employment agreements;

- the material terms of awards reported, such as performance conditions, vesting conditions and formula or criteria used to determine the amount payable;

- where applicable, whether dividends or dividend equivalents accrue on stock awards and the applicable dividend rate; and

- any performance-based conditions and any other material conditions applicable to the award.

Companies should examine the assumptions used for valuing equity awards and pension benefits before they are finalized for financial reporting purposes to determine whether it would be appropriate to refine those assumptions as they relate to benefits provided executives. For example, companies that apply the same SFAS 123(R) assumptions for all employee stock options may wish to segregate options granted to executive officers if it would be appropriate to apply different assumptions in valuing those options for financial statement and proxy reporting purposes.

The All Other Compensation Column and Perquisite Disclosure

The All Other Compensation column includes any other element of compensation unless it is reportable in another column of the Summary Compensation Table or there is a specific instruction indicating that the particular element of compensation is not reportable in the Summary Compensation Table. Examples of compensation to be included in this column are:

- perquisites valued in the aggregate at $10,000 or more;

- all tax gross-ups or other amounts reimbursed during the fiscal year for the payment of taxes, including tax gross-ups on perquisites;

- the amount paid or that becomes due to any NEO in connection with any termination of employment or change in control of the company;

- company contributions or other allocations to tax-qualified and non-tax qualified defined contribution plans (whether or not vested);

- the dollar value of any insurance premiums paid by, or on behalf of, the company during the fiscal year with respect to life insurance for the benefit of an NEO; and

- the dollar value of dividends or other earnings paid in stock or option awards, when those amounts were not factored into the grant date fair value required to be reported in the stock or option awards.

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Amounts not reportable in this column include:

- the value realized upon exercise of options or vesting of restricted stock;
- dividends and dividend equivalent payments on stock awards and options, unless the value of those dividends was not taken into account when determining the grant date fair value of the stock awards and options; and
- benefits paid pursuant to defined benefit pension plans unless the payment is accelerated due to a change in control.

Footnotes to the All Other Compensation column are required to identify and quantify any item reported in this column whose value exceeds $10,000, other than perquisites. Perquisites received by an NEO must be separately identified if their aggregate incremental cost exceeds $10,000 and must be separately quantified to the extent their incremental cost exceeds the greater of $25,000 or 10% of the value of all perquisites received by the NEO. The rules also require footnote disclosure of the methodology a company uses for computing the aggregate incremental cost of perquisites.

The SEC reiterated and elaborated on the standard it applies in determining whether an item is a perquisite or other personal benefit. Under the SEC's two-step analysis:

- An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties.
- Otherwise, an item is a perquisite or personal benefit 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 for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.

The SEC explained that if an item is integrally and directly related to the performance of duties, then the fact that it also confers a personal benefit or is not generally provided to others does not make the item a perquisite. For example, if an NEO is permitted to travel in Business Class on a flight from the company's headquarters to a business meeting, that travel is not a perquisite even if others are required to travel in Coach class. Likewise, a larger office in the corporate headquarters is not considered a perquisite.

In contrast, if a benefit is not integrally and directly related to an executive's job, the fact that it has a business purpose or facilitates the executive's job performance does not prevent it from being a perquisite. Likewise, a benefit's characterization or treatment under tax rules is not determinative of whether it is a perquisite. Thus, the SEC states that perquisites include commuting benefits (whether or not for the company's convenience or benefit), personal use of planes, boats or automobiles owned or leased by the company, payment of housing or living expenses and security provided at a personal residence or during personal travel. If a benefit is a perquisite, the incremental cost of the benefit is required to be reported. Thus, for example, while club memberships not used exclusively for business entertainment purposes are viewed by the SEC as perquisites, companies must disclose only the incremental cost of the non-business use.

Grants of Plan-Based Awards Table

The Summary Compensation Table is accompanied by a Grants of Plan-Based Awards Table that provides additional detail regarding stock options and other equity awards (such as restricted stock and restricted stock units) granted during the last fiscal year and amounts payable under other compensation plans (such as long-term incentive awards that are payable in cash or stock).

Grants of Plan-Based Awards in Fiscal Year 200x

		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 ($/Sh)
Name	Grant Date	Threshold ($)	Target ($)	Maximum ($)	Threshold (#)	Target (#)	Maximum (#)			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
NEOs										

- Each grant of an award made to each NEO under each plan must be disclosed on a separate line.
- The Grant Date column is required to be completed only for equity-based awards.
- Amounts reported in the Estimated Future Payouts Under Non-Equity Incentive Plan Awards column for a particular year are not reported in the Summary Compensation Table for that year, except that if the award is based on annual performance the actual amount earned under the award is reported in the Summary Compensation Table in the same year the award is reported in this table. In contrast, awards reported in any other column in this table also are reported in the Summary Compensation Table at their grant date fair value for the same year in which they appear in this table.

In response to recent concerns about stock option grant practices, the Grants of Plan-Based Awards Table "expands" in certain circumstances to include additional information applicable to equity awards. Specifically:

- if the date on which the compensation committee takes action or is deemed to take action to grant an equity-based award is different from the date of grant as determined under SFAS No. 123(R), a column must be added between columns (b) and (c) to disclose the date action was taken to authorize the action; and

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- if the exercise price of options reported in the Grants of Plan-Based Awards Table is less than the closing market price of the underlying security on the grant date (for example, if the exercise price is the average of the high and low stock price on the grant date), an additional column must be added after column (k) showing market price on the grant date.

Outstanding Equity Awards at Fiscal Year-End Table

The Outstanding Equity Awards at Fiscal Year-End Table presents information on each outstanding equity award held by companies' NEOs at the end of the last fiscal year, including the number of securities underlying both exercisable and unexercisable portions of each stock option as well as the exercise price and expiration date of each outstanding option.

Outstanding Equity Awards at 200x Fiscal Year-End

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)	Equity Incentive Plan Awards: Number 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)
NEOs									

- Information on option holdings must be presented on a grant-by-grant (instead of aggregate) basis, but (in contrast to what has been required) a company is not required to present a single line "total" that aggregates the number and value of all options held by an NEO.

- The number of shares subject to outstanding Stock Awards and their aggregate value may be reported on a single line, as can the number of shares subject to and the aggregate value of Equity Incentive Plan Awards.

- Footnote disclosure is required to state the vesting dates for each option and for stock awards and equity incentive plan awards reflected in this table.

- If options or stock awards are subject to performance conditions, they are reported in column (d) or columns (i) and (j), respectively. If the performance conditions have been satisfied but the awards remain subject to forfeiture or service-based vesting conditions, then the awards remain in this table but are shifted into columns (b) and (c) or columns (g) and (h) until they are exercised or vest.

- The number of shares subject to performance-based incentive plan awards valued or payable in stock reported in column (i) and the payout value of those awards reported in column (j) generally is determined based on achieving threshold performance goals. However, if the previous fiscal year's performance has exceeded the threshold, the amount disclosed should be based on the next higher performance measure (target or maximum) that exceeds the previous fiscal year's performance. If the award provides only for a single estimated payout, that amount should be reported. If the target amount is not determinable, companies must provide a representative amount based on the previous fiscal year's performance.

- This table includes awards that have been gifted or transferred other than for value, and footnote disclosure is required to provide information about the nature of the transfer.

Option Exercises and Stock Vested Table

The Option Exercises and Stock Vested Table shows amounts realized by NEOs on each option that was exercised and each stock award that vested during the last fiscal year.

Option Exercises and Stock Vested in Fiscal Year 200x

	Option Awards		Stock Awards	
Name	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)
NEOs				

- In contrast to what the SEC proposed, companies are not required to disclose the SFAS 123(R) grant date value of awards reported in this table.

- Footnotes to the Option Exercises and Stock Vested Table are required to include information quantifying the amount and terms of any amount deferred upon exercise of an option or vesting of a stock award.

Pension Benefits Table

The Pension Benefits Table discloses the actuarial present value of each NEO's accumulated benefit under each pension plan, assuming benefits are paid at normal retirement age based upon current levels of compensation.

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Pension Benefits for the 200x Fiscal Year

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

- A separate line is required to report each pension plan or defined benefit-type plan or arrangement in which the NEO participates that provides for retirement payments and benefits primarily following retirement, including but not limited to tax-qualified defined benefit plans, cash balance plans and supplemental executive retirement plans.
- The value of benefits are calculated based on normal retirement age (or if a plan does not specify normal retirement age, the earliest age at which benefits become payable without reduction), calculated as of the same measurement date the company uses for financial statement reporting purposes and using the same assumptions that the company uses for financial statement purposes.
- The benefit amount reported in this table is the same used to calculate the year-to-year Change in Pension Value in the Summary Compensation Table.
- Footnotes are required to report any additional years of credited service and the resulting dollar value of the benefit augmentation if there is a difference between an NEO's number of years of credited service and the NEO's actual years of service.
- In the narrative section following this table, the company must include the valuation and material assumptions applied when quantifying the present value of the current accrued benefit of pension benefits. This disclosure may be satisfied by reference to the discussion of the assumptions in the company's financial statements, footnotes to the financial statements, or the discussion in the MD&A.
- The narrative description must also disclose the material factors necessary to understand each plan reflected in this table, including:
  - the material terms and conditions of payments and benefits available under the plan;
  - if any NEO is currently eligible for early retirement, the identity of the NEO and the plan, the plan's early retirement payment and eligibility standards;
  - the specific elements of compensation included in applying the payment and benefit formula;
  - if a company has multiple plans, the different purposes for separate plans; and
  - any policies with respect to granting extra years of service.

Nonqualified Deferred Compensation Table

The Nonqualified Deferred Compensation Table discloses annual executive and company contributions under non-qualified defined contribution and other deferred compensation plans, as well as each NEO's withdrawals, "earnings" and fiscal-year end balances in those plans.

Nonqualified Deferred Compensation for the 200x Fiscal Year

Name (a)	Executive Contributions in Last Fiscal Year ($) (b)	Registrant Contributions in Last Fiscal Year ($) (c)	Aggregate Earnings in Last Fiscal Year ($) (d)	Aggregate Withdrawals/ Distributions ($) (e)	Aggregate Balance at Last Fiscal Year-End ($) (f)
NEOs					

- This table covers only deferred compensation that is not provided under a tax-qualified plan.
- While not defined or described by the SEC, "earnings" presumably reflect the difference in the account balance between the beginning and end of the year, less any executive or company contributions and plus any amounts withdrawn or distributed.
- Footnotes to this table are required to quantify the extent to which amounts reported as contributions or earnings are also included in the amounts reported as compensation in the last completed fiscal year in the Summary Compensation Table. Footnote disclosure is also required to quantify the extent to which amounts reported in the Aggregate Balance at the Last Fiscal Year-End column were reported as compensation to the NEOs in the company's Summary Compensation Table for prior years, although it is unclear whether this footnote is to include only deferred amounts reported as compensation in the Summary Compensation Table of the current year's proxy, all deferred amounts reported in the Summary Compensation Table of all past years' proxy statements or simply the aggregate amount of employee contributions to the plan for all years.
- Following this table, a narrative description should be included describing any material factors necessary to understand each plan covered by this table. Examples of material factors include:
  - the types of compensation permitted to be deferred, and any limitations on the extent to which deferral is permitted;
  - the measures for calculating interest or other plan earnings, quantifying interest rates and other earnings measures applicable during the company's last fiscal year; and
  - material terms with respect to payouts, withdrawals and other distributions.

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Extensive Disclosure of Termination and Change in Control Payments

The rules require companies to describe any arrangement that provides for payments or benefits to any NEO at, following, or in connection with a change in control of the company, a change in an NEO's responsibilities, or an NEO's termination of employment, including resignation, severance, retirement or constructive termination. The disclosure must explain the specific circumstances that would trigger payment or the provision of benefits and how the payment or benefit levels are determined in each circumstance. In addition, companies must quantify the amount that would have been payable to each NEO under each of the foregoing triggering events, assuming that the triggering event had occurred as of the end of the last fiscal year. Any benefits that are valued based on stock price likewise are to be quantified based on that price as of the end of the last fiscal year. If uncertainties exist as to whether benefits are payable or the amount or value of such benefit, companies are required to make a reasonable estimate (or a reasonable estimated range of amounts) of the payment or benefit and disclose material assumptions underlying such estimates or estimated ranges in its disclosure. For an NEO who has terminated employment during the last fiscal year, only the actual benefits paid or payable must be reported.

The disclosure must also:

- describe and explain 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 agreements, including the duration of such agreements and provisions regarding waiver of breach of such agreements; and

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

For many companies, this new disclosure standard will be the most burdensome and time-consuming aspect of the new rules. Companies must carefully review all of their employment agreements, benefit plans and compensation arrangements to identify each triggering event and the amounts and benefits payable. Companies with slight variances in terms among their different benefits (such as different definitions of "change in control") might wish to amend some of their arrangements to conform the terms. The required disclosure may necessitate quantifying current pension benefits (which, unless an NEO is retirement-eligible, may involve a calculation that is different from the one used to prepare the Pension Benefits Table) and the value of "golden parachute tax" gross-ups, each of which likely will require complex calculations that may best be performed by outside consultants.

Companies will also need to carefully consider how to most clearly present the required information, including whether to arrange the presentation by triggering event or by NEO, and the extent to which tabular presentations can be used to facilitate making the required disclosures. Because the amounts reported typically will be based on hypothetical circumstances, companies will also want to adequately explain (and disclaim) that amounts payable upon a triggering event could differ, perhaps materially, from those reported in the proxy statement.

Director Compensation Table

Director compensation for the last fiscal year is reported in a tabular format based on the form of payment. A separate line must be provided for each director, except that directors may be grouped in a single row if all of the elements and amounts of their compensation are identical.

Director Compensation in Fiscal 200x

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

- The All Other Compensation Column covers the same items reported for NEOs in the All Other Compensation column of the Summary Compensation Table, with the same $10,000 thresholds for itemizing elements of All Other Compensation and the same $10,000 *de minimis* exception to the disclosure of perquisites. In addition, All Other Compensation includes:
    - all consulting fees; and
    - the annual cost of payments and promises of payments pursuant to director legacy programs or charitable awards programs.

- Footnotes are required to accompany the Stock Awards and Option Awards columns to report the aggregate number of stock awards and option awards outstanding at fiscal year end.

- Narrative disclosure accompanying this table should describe director compensation arrangements (such as fees for retainer, committee service, service as chair of the board or a committee, and meeting fees) and any other material factors necessary to the understanding of this table.

Stock Option Grant Practices

As noted above, in response to recent concerns about stock option grant practices, the rules and adopting release address disclosure requirements focusing on the timing of option grants in coordination with the release of material non-public information and the determination of exercise prices that differ from the stock price on the date of grant. In addition to the tabular disclosures addressed above, CD&A disclosure is required regarding option grant practices, when necessary for a material understanding of the company's compensation policies. With respect to both the timing of stock options and any programs under which option exercise prices are set at an amount below the closing market price of the stock on the grant date, companies must, where applicable, answer questions such as:

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- Does the company have a program or practice in place to time option grants to executive officers with the release of material non-public information (or to set exercise prices in coordination with such release)?
- How does that program or practice fit into the context of the company's program or practice, if any, with regard to option grants to employees generally?
- What was the compensation committee's role in approving and administering that program or practice?
- What was the role of executive officers in the company's program or practice?
- Does the company plan to time, or has it timed, the release of material non-public information in order to affect the value of executive compensation?

Related Party Transactions

The rules revise the related party transaction disclosure requirements in subtle but significant ways. The SEC noted that the purpose of these rules remains unchanged: to elicit disclosure of transactions and relationships with related persons and the independence of directors and director nominees. The rules eliminate a number of "bright-line" standards on relationships that were not required to be disclosed, focusing instead on the materiality standard, which should be "determined on the basis of the significance of the information to investors in light of all the circumstances."

Disclosure Standards for Related Party Transactions

Item 404(a) of Regulation S-K continues to set forth a general disclosure requirement for related party transactions: disclosure is required of any transaction (or proposed transaction) since the beginning of the company's last fiscal year, in which (i) the company was a participant, (ii) the amount involved exceeds $120,000, and (iii) any related person had or will have a direct or indirect material interest. The threshold dollar value of transactions to be considered is increased from $60,000 to $120,000, but the SEC has emphasized that transactions over this threshold are reportable only if they satisfy the materiality standard. The SEC has emphasized that the scope of what constitutes a "transaction" is broad and includes both compensatory relationships and indebtedness.

The definition for "related person" covers:

- any person who served as an executive officer or director at any time during the previous fiscal year (regardless of whether they held that position at the time of the transaction) or (for proxy statements) is a director nominee;
- any person who was a greater than 5% securityholder at the time of a transaction or while the transaction was continuing; and
- any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of any of director, executive, director nominee or securityholder, the foregoing related persons, as well as any other person (other than a tenant or employee) sharing the household of any such related person. The scope of this "immediate family" definition is broader than previously applied under Item 404(a) because it includes stepparents, stepchildren and others living in an executive's or director's household.

The rules retain a number of "bright line" exclusions on relationships that are not reportable and confirm that compensation of executive officers who are not NEOs will not generally be reportable. Thus, companies need not report any transaction:

- with an entity in which the related person's interest arises solely from being a director or less than 10% stockholder of the other party to the transaction, or from being both a director and less than 10% stockholder; or
- involving compensation to an executive officer who is not an NEO, provided that the executive officer is not an immediate family member of a related person and the compensation has been approved by the company's compensation committee or other independent directors.

On the other hand, the revisions eliminate an important exception that in the past was relied upon as a basis for not disclosing *de minimis* transactions with companies at which directors are executive officers. Specifically, the SEC has replaced Item 404(b), which required disclosure of transactions with entities where a director or director nominee served as an executive officer, with a new rule (discussed below) adopting stock exchange listing standards for evaluating director independence. This has the effect of eliminating companies' ability to rely upon a well-established SEC staff interpretation that related person disclosure was not required under Item 404(a) of any business dealings that were not disclosible under Item 404(b). While companies may still conclude that many such transactions or business relationships do not need to be disclosed, that conclusion will be dependent on a facts-and-circumstances analysis of the transaction and a determination of whether the director has a direct or indirect material interest in the transaction under general Item 404(a) standards. Also, in light of the elimination of the Item 404(b) standards for disclosure of transactions with entities where a director or director nominee served as an executive officer, the SEC has amended the definition of "Non-Employee Director" under Rule 16b-3 to drop this element from the definition and to provide safe harbor procedures for determining whether a director qualifies as a "Non-Employee Director" for purposes of that rule.

Approval of Related Party Transactions

New Item 404(b) requires companies to describe their policies and procedures for the review and approval or ratification of transactions with related persons. The rule provides the following examples of aspects of the policies and procedures that may need to be discussed:

- the types of transactions that are covered by such policies and procedures;
- the standards to be applied pursuant to such policies and procedures;

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- the persons or groups of persons on the board of directors or otherwise who are responsible for applying such policies and procedures; and
- a statement of whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced.

Companies will need to disclose whether any related party transactions that are required to be disclosed under Item 404(a) were not subject to the company's policies for approval or ratification.

We expect that these rule changes will lead many companies to reinforce their procedures for timely identifying potential related party transactions and to clarify and formalize their procedures relating to approval of related party transactions.

Corporate Governance Disclosures

New Item 407 of Regulation S-K consolidates existing disclosure requirements relating to directors' board and annual meeting attendance and shareholder communications with directors and nominating and audit committees. The rules also include new disclosure standards relating to director independence and compensation committee operations. The revisions eliminate the need to periodically attach the audit committee's charter to the proxy statement, and instead all committee charters may instead by posted on a company's website and cross-referenced in the proxy statement.

The new Item 407 rules regarding independent directors require companies to:

- identify each person who served as a director during any part of the year and each director nominee who is "independent," using the independence standards applied under the securities market where the company's stock trades;
- identify any member of the audit, nominating or compensation committees of the board who is not independent, and describe the listing standard exemption relied upon for having a non-independent director; and
- describe in reasonable detail on a director-by-director basis each category or type of transaction, relationship or arrangement that is not disclosed as a related party transaction but that was considered by the company's board when determining that a director and director nominee is independent.

The new Item 407 rules regarding compensation committees require companies to describe the compensation committee's processes and procedures for the consideration and determination of executive and director compensation. If director compensation is not set by the compensation committee, then corresponding disclosure must be provided with respect to the committee or group of directors that are responsible for establishing directors' compensation. The disclosure must address:

- the scope of authority of the compensation committee;
- the extent to which the compensation committee may delegate any of its authority to others, specifying what authority may be so delegated and to whom;
- any role of executive officers in determining or recommending the amount or form of executive and director compensation; and
- any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, including:
  - identifying the compensation consultants,
  - stating whether the consultants are engaged directly by the compensation committee, and
  - describing the nature and scope of the consultant's assignment, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

Form 8-K Reporting Requirements

The new rules revise and significantly narrow the Form 8-K reporting requirements applicable to compensation-related information. As noted above, compliance with the changes to Form 8-K is required for triggering events that occur 60 days or more after publication of the adopting release in the Federal Register. The rules:

- Remove compensation related plans, agreements and arrangements as reportable events under Items 1.01 and 1.02 of Form 8-K. Although compensation-related events are no longer reportable as "material agreements" under the Form 8-K rules, they continue to be treated as "material agreements" under the rules enumerating exhibits that are required to be filed with registration statements and Forms 10-K and 10-Q.
- Add to and expand the executive compensation-related events that require a Form 8-K report under Item 5.02 of Form 8-K. That item formerly applied only upon appointment or upon resignation or severance of a director, principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or person performing similar functions. In addition to events that formerly triggered a Form 8-K under Item 5.02, that item now also is triggered:
  - whenever a company enters into, adopts, commences or materially modifies or amends a material compensatory plan, contract or arrangement (whether or not written) in which a principal executive officer, principal financial officer or person identified as an NEO in the company's most recently proxy statement participates; and
  - whenever a company makes or materially modifies a material grant or award under any plan, contract or arrangement to or with any principal executive officer, principal financial officer or person identified as a NEO in the company's most recently proxy statement, unless the grant or award (or modification thereto) is "materially consistent

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with the previously disclosed terms of such plan, contract or arrangement," and the grant, award or modification is disclosed when required in the company's next proxy statement (or other filing reporting compensation of NEOs under Item 402 of Regulation S-K).

As with the case when compensatory plans or arrangements were reported under Item 1.01, the failure to timely file a Form 8-K reporting one of the foregoing two types of triggering events will not impair a company's eligibility under Form S-3, as long as the event is reported in the Form 10-Q or Form 10-K filed after the end of the quarter in which the triggering event occurred.

- In addition, under amendments to other provisions of Item 5.02, a Form 8-K must be filed:
  - whenever a company calculates the amount of an NEO's salary or bonus for the previous fiscal year if that amount was not reported in the company's previously filed proxy statement (or other filing reporting compensation of NEOs under Item 402 of Regulation S-K) for that fiscal year; and
  - whenever a person identified as an NEO in the company's most recently proxy statement (or other filing reporting compensation of NEOs under Item 402 of Regulation S-K) retires, resigns or otherwise terminates employment.
- The rules set forth more clearly the information required to be described when a company appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or person performing similar functions. In addition to describing any employment agreement with the newly appointed executive, companies must describe: (i) any material plan, contract or arrangement (whether or not written) in which the newly appointed executive participates that is materially amended in connection with the executive's appointment; and (ii) any grant or award that is made to the newly appointed executive in connection with the appointment.
- Significantly, events relating to establishing or amending director compensation are not required to be reported on a Form 8-K, except that if a company appoints a new director, the Form 8-K filed in connection with that appointment must describe: (i) any material plan, contract or arrangement (whether or not written) in which the newly appointed executive participates that is entered into or materially amended in connection with the executive's appointment; and (ii) any grant or award that is made to the newly appointed executive in connection with the appointment.
- Companies are not required to file a Form 8-K to report compensation-related events that relate only to executives who are not NEOs except for (i) the triggering events discussed above that apply upon the appointment or termination of a principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer, or other person performing similar functions; and (ii) events that trigger disclosure under other Form 8-K items such as plan trading "black outs" that are reportable under Item 5.04 of Form 8-K and plans of termination that involve a material charge and therefore are reportable under Item 2.05 of Form 8-K.

Other Requirements

- *Security Ownership of Directors and Officers*: The rules require disclosure of the number of shares owned by management that are subject to a pledge.
- *Performance Graph*: The SEC retained the requirement for the stock performance graph, but the graph is not required to appear in the proxy statement but instead is called for under the rules setting forth requirements applicable to companies' annual report to stockholders.
- *Plain English*: The rules require companies to present most of this information in plain English.
- *Disclosure of Other Employees' Compensation*: The SEC did not adopt its proposal to require disclosure of the compensation paid to non-executive employees whose compensation exceeds that paid to any of the NEOs. However, the SEC has sought additional comment on a revised version of this proposal, under which companies that are "large accelerated filers" would be required to disclose the total compensation of up to three employees (i) who are not executive officers but who have significant policy-making powers either within the company or within a significant subsidiary, principal business unit, division or function of the company; and (ii) whose compensation exceeds that of any of the NEOs listed in the Summary Compensation Table. Companies wishing to submit comments on this proposal must do so within 45 days after the SEC release is published in the Federal Register.

Gibson, Dunn & Crutcher lawyers are available to assist clients in addressing questions they may have regarding these issues. Please contact the Gibson Dunn attorney with whom you work, or John F. Olson (202-955-8522, jolson@gibsondunn.com), Ronald Mueller (202-955-8671, rmueller@gibsondunn.com), Brian Lane (202-887-3646, blane@gibsondunn.com), Amy L. Goodman (202-955-8653, agoodman@gibsondunn.com), Stephen Fackler (650-849-5385, sfackler@gibsondunn.com), James Moloney (949-451-4343, jmoloney@gibsondunn.com), or Elizabeth Ising (202-955-8287, eising@gibsondunn.com).

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COMPENSATION DISCUSSION AND ANALYSIS

The SEC's new rules set forth the following description of the types of matters that may need to be discussed in the Compensation Discussion and Analysis:

While the material information to be disclosed under Compensation Discussion and Analysis will vary depending upon the facts and circumstances, examples of such information may include, in a given case, among other things, the following:

(i) The policies for allocating between long-term and currently paid out compensation;
(ii) The policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation;
(iii) For long-term compensation, the basis for allocating compensation to each different form of award (such as the relationship of the award to the achievement of the registrant's long-term goals, management's exposure to downside equity performance risk, correlation between cost to registrant and expected benefits to the registrant);
(iv) How the determination is made as to when awards are granted, including awards of equity-based compensation such as options;
(v) What specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions;
(vi) How specific forms of compensation are structured and implemented to reflect these items of the registrant's performance, including whether discretion can be or has been exercised (either to award compensation absent attainment of the relevant performance goal(s) or to reduce or increase the size of any award or payout), identifying any particular exercise of discretion, and stating whether it applied to one or more specified named executive officers or to all compensation subject to the relevant performance goal(s);
(vii) How specific forms of compensation are structured and implemented to reflect the named executive officer's individual performance and/or individual contribution to these items of the registrant's performance, describing the elements of individual performance and/or contribution that are taken into account;
(viii) Registrant policies and decisions regarding the adjustment or recovery of awards or payments if the relevant registrant performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment;
(ix) The factors considered in decisions to increase or decrease compensation materially;
(x) How compensation or amounts realizable from prior compensation are considered in setting other elements of compensation (e.g., how gains from prior option or stock awards are considered in setting retirement benefits);
(xi) With respect to any contract, agreement, plan or arrangement, whether written or unwritten, that provides for payment(s) at, following, or in connection with any termination or change-in-control, the basis for selecting particular events as triggering payment (e.g., the rationale for providing a single trigger for payment in the event of a change-in-control);
(xii) The impact of the accounting and tax treatments of the particular form of compensation;
(xiii) The registrant's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership), and any registrant policies regarding hedging the economic risk of such ownership;
(xiv) Whether the registrant engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (including component companies); and
(xv) The role of executive officers in determining executive compensation.

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