Executive Compensation and Related Person Disclosure

By Elizabeth A. Brower, J. Mark Poerio and Michael L. Zuppone

OVERVIEW

On July 26, 2006, after reviewing over 20,000 comment letters in response to its earlier proposal, the Securities and Exchange Commission (the “SEC”) adopted comprehensive changes to the disclosure requirements for executive and director compensation, related person transactions, director independence and other corporate governance matters, and security ownership of officers and directors. The adopting release was published on August 29, 2006, and can be found at http://www.sec.gov/rules/final/33-8732A. The new disclosure rules fundamentally alter the SEC’s executive compensation disclosure requirements and will be in effect for the 2007 proxy season.

In general, the new rules are intended to:

• make proxy and information statements, reports and registration statements easier to understand;

• provide investors with a more complete picture of compensation earned by a company’s principal executive officer, principal financial officer and highest paid executive officers and members of its board of directors; and

• provide better information about key financial relationships among companies and their executive officers, directors, significant stockholders and their respective immediate family members.

COMPENSATION DISCUSSION AND ANALYSIS

The centerpiece of the SEC’s new rules is a new requirement for narrative disclosure detailing the material elements of a company’s compensation policies and practices, as well as compensation committee procedures and processes for determining executive and director compensation. The SEC has called this narrative a “Compensation Discussion and Analysis” (the “CD&A”). The CD&A is intended to put into perspective for investors the quantitative and narrative disclosures that follow it in the proxy statement.

As adopted, the CD&A requirement is principles-based in that it sets forth the disclosure requirement in concept and provides several illustrative examples. A company must address the compensation policies it applies even if not included in the examples. The SEC’s view is that utilizing a disclosure concept along with illustrative examples strikes an appropriate balance that will effectively elicit meaningful disclosures, even as new compensation vehicles develop over time. The CD&A should avoid boilerplate disclosure and reflect the individual circumstances of the company.

In addressing its compensation policies, a company should explain material elements of its compensation for named executive officers by answering the following questions:

• What are the objectives of the company’s compensation programs?

• What is the compensation program designed to reward?

• What is each element of compensation?

• Why does the company choose to pay each element?

• How does the company determine the amount (and where applicable, the formula) for each element?

Examples given as appropriate issues to address include the following:

• policies for allocating between long-term and currently paid out compensation;

• the basis for allocating long-term compensation to each different form of award;

• policies for allocating between cash and non-cash compensation, and among the various types of non-cash compensation;

• how the determination is made as to the timing of the grant of awards, including equity-based awards;

• specific items of corporate performance taken into
account in setting compensation policies and making compensation decisions;

• how specific elements of compensation are structured and implemented to reflect corporate performance and individual performance, including whether discretion can be or has been exercised;

• factors considered to materially increase or decrease compensation;

• how compensation or amounts realizable from prior compensation (i.e., gains from prior options) are considered in setting other elements of compensation;

• impact of accounting and tax treatments of a particular form of compensation;

• the company’s equity or other security ownership guidelines and company policies regarding hedging the economic risk of such ownership;

• benchmarking of total compensation or any material element of compensation, if any, identifying the benchmark and its components; and

• the role of executive officers in the compensation process.

Two additional illustrative examples were added as a result of concerns raised by commenters:

• policies and decisions regarding adjustment or recovery of awards if relevant performance measures are restated or otherwise adjusted in a manner that would reduce the size of the award; and

• with respect to any contract or plan that provides for payment on termination or change in control, the basis for selecting particular events as triggering payment.

Practice Tip: Begin now!! Drafting the CD&A will take a significant amount of time. Prepare drafts of what you expect the disclosure tables to look like so that you have a reference point for drafting the CD&A. Be sure to also consider potential public reaction to the required disclosure. Early drafting will allow a compensation committee so inclined time to consider modifications to compensation programs.

The CD&A should cover not only the last fiscal year, but also current compensation policies and practices.

Disclosure of Specific Target Levels

Companies are not expected to disclose target levels with respect to specific quantitative or qualitative performance-related factors considered by the compensation committee or board of directors, or any factors involving confidential commercial information, the disclosure of which would have an adverse effect on the company. However, the standard for whether disclosure would have an adverse effect on the company will be the same standard under the Freedom of Information Act (“FOIA”) rules as would apply when companies request confidential treatment of confidential trade secrets and commercial or financial information that would otherwise be disclosed in a registration statement, periodic report or other document filed with the SEC. This is a rigorous standard that suggests companies should review prior non-disclosures and adjust their disclosure controls and procedures to document adequately the competitive harm to the company that would satisfy the FOIA standard for non-disclosure. In some cases specific targets, such as general company-wide, segment or business unit financial targets, while heretofore treated as non-public and closely guarded information, will not meet the new FOIA based non-disclosure standard. Companies are not required to submit official confidential treatment requests, but will be expected to demonstrate to the SEC staff the basis for excluding disclosure of specific targets who will comment on the same in connection with the staff’s review of the filings.

To mitigate concerns that the omission of specific targets to the extent permitted under the FOIA based non-disclosure standard would impair the quality of disclosure, a company must disclose how difficult it will be for the executive or how likely it will be for the company to achieve the undisclosed target levels. As adopted, the rules also clarify that disclosure of a target level that applies a non-GAAP financial measure will not be subject to the general rules regarding disclosure of non-GAAP financial measures, but the company must disclose how the number is calculated from the audited financial statements.

Practice Tip: Be sure to document any decision to exclude disclosure of performance targets. Performance targets may only be excluded to the extent such information involves a trade secret or commercial or financial information the disclosure of which would result in competitive harm.

Filed Not Furnished

The CD&A will constitute soliciting material and will be treated as “filed” with the SEC. Therefore the CD&A will be subject to Section 18 liability under the Exchange Act, and to the extent it is incorporated by reference into a periodic report (as is typically the case with proxy statement incorporation into the Form 10-K annual report), the disclosure would be covered by the personal certifications required to be made by the principal executive officer and principal financial officer under the Sarbanes-Oxley Act of 2002.

Practice Tip: Compensation committees should work with CEOs and CFOs and revisit their company's
disclosure controls and procedures to assure the participation of individuals best positioned to facilitate compliance with the new CD&A requirements.

**Options Disclosure**

As a result of the recent scandals involving the timing of option grants, the SEC specifically targeted options disclosure in the new rules. The CD&A requires detailed disclosure about a company’s practice with respect to timing of options grants (either before the release of positive news or after the release of negative news), and setting the exercise price based on a date other than the actual grant date. (See Paul Hastings’ Client Alert entitled “Stock Option Grant Practices Under Scrutiny – The SEC Weighs In” available at www.paulhastings.com).

**COMPENSATION COMMITTEE REPORT AND PERFORMANCE GRAPH**

Both the Compensation Committee Report and the Performance Graph were retained in some fashion, despite the fact that the SEC initially proposed eliminating both.

**Compensation Committee Report**

The new compensation committee report will not require specific disclosure regarding executive compensation; instead it requires the compensation committee to state (i) whether it reviewed and discussed the CD&A with management, and (ii) based on review and discussions, whether it recommended to the board that the CD&A be included in the company’s Form 10-K annual report and as applicable, the company’s proxy or information statement. The compensation committee report must be included or incorporated by reference into the Form 10-K annual report and will only be required one time during any fiscal year. The names of the compensation committee members (or those performing the same function) must appear below the report.

As previously discussed, the CD&A is “filed” disclosure and therefore subject to principal executive officer and principal financial officer personal certifications. On the other hand, the compensation committee report will continue to be “furnished” and not “filed” and therefore will not be covered by the personal certifications. In response to commenter’s concerns that these officers would be inappropriately inserted into the compensation committee’s deliberative process, the SEC advised that the principal executive officer and principal financial officer will be able to look to the compensation committee report in providing their required certifications relative to the CD&A, but that they will not need to certify as to the compensation committee deliberations.

**Performance Graph**

The performance graph requirement has been retained because of the significance of the disclosure to a broad spectrum of commenters, but it will not be part of executive compensation disclosure. It will be required only in a company’s annual report to security holders that accompanies or precedes a proxy statement relating to an annual meeting. The performance graph will now be included in the disclosure item entitled “Market Price of and Dividends on the Registrant’s Common Equity and Related Stockholder Matters.” The performance graph will continue to be “furnished” and not “filed” and will not be deemed to be soliciting material.

**COMPENSATION TABLES**

Supplementing the CD&A are a series of tables that build from the tables that currently are required for summary annual compensation and long-term stock awards. The SEC’s amended rules include a table for director compensation and reorganize the executive compensation tables into three broad categories to provide a clearer picture of total compensation and the elements of total compensation for each named executive officer:

- **Summary compensation** — Compensation with respect to the last fiscal year and the two preceding fiscal years (as reflected in the Summary Compensation Table) and compensation consisting of current earnings, deferred compensation, or awards that are part of a plan (as supplemented by separate tabular disclosure clarifying certain data in the Summary Compensation Table).

- **Equity-based compensation** — Holdings of equity-based interests that relate to compensation or are potential sources of future compensation.

- **Retirement and other post-termination compensation** — Retirement and deferred compensation plans, other retirement benefits and other post-employment benefits including those payable upon a change in control.

The SEC acknowledged in its adopting release the possible perception of “double counting” for compensation, but clarified that “a particular item of compensation only appears once in the Summary Compensation Table.”

The following table provides some general comparative information about these compensation tables.
<table>
<thead>
<tr>
<th>Former Table</th>
<th>Amended Table</th>
<th>Primary Changes from Former Table</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Summary Compensation”</td>
<td>Same Title followed by narrative disclosure “of material factors necessary to an understanding of the information disclosed in the tables”.</td>
<td>Adds a “Total” column which equals the sum of the other 7 columns (with stock awards disclosed based on dollar values). Also adds new columns for (i) increased pension amounts and earnings on deferred compensation, and (ii) an “All Other Compensation” column for items such as perquisites, tax reimbursements, and, and other all other items not properly reportable under other columns.</td>
</tr>
<tr>
<td>“Long-Term Incentive Plan – Awards in Last Fiscal Year” and “Option/ SAR Grants In Last Fiscal Year”</td>
<td>“Grants of Plan Based Awards”, followed by explanatory narrative disclosure.</td>
<td>Uses dollar disclosures and “performance” standard of FAS 123R for separate columns for equity versus non-equity awards; with sub-columns of each for estimated future payouts at threshold, target, and maximum. Also covers non-performance-based equity awards where payout is tied to stock price; supersedes and eliminates current tables, with deletion of disclosure regarding potential realizable values.</td>
</tr>
<tr>
<td>None</td>
<td>“Outstanding Equity Awards at Fiscal Year-End”</td>
<td>Consolidates disclosure with numbers of shares and in-the-money dollar values for outstanding stock options, SARs, restricted stock or units, incentive, and similar equity-based awards.</td>
</tr>
<tr>
<td>“Aggregated Option/SAR Exercises in Last Fiscal Year and FY-End Option/SAR Values”</td>
<td>“Option Exercises and Stock Vested”</td>
<td>Expands current table to include compensation attributable to the exercise of options and vesting of restricted stock.</td>
</tr>
<tr>
<td>“Pension Plan Table”</td>
<td>“Pension Benefits”</td>
<td>Consolidates disclosure of tax-qualified and non-qualified pension benefits at present value of accrued plan benefit (with years of service added as a new column).</td>
</tr>
<tr>
<td>None</td>
<td>“Nonqualified Deferred Compensation”</td>
<td>Discloses contributions, earnings, withdrawals, and balances under these plans (rather than merely above-market earnings per current rule).</td>
</tr>
<tr>
<td>None</td>
<td>“Director Compensation”</td>
<td>Includes columns for total compensation, cash fees, stock awards ($), option awards ($), incentive compensation, and other compensation.</td>
</tr>
</tbody>
</table>
The amended rules contain new narrative disclosure requirements in order to provide context to the tabular disclosure, including any additional material factors necessary to understand the information being disclosed in the tables. This narrative is unlike the broader discussion of the CD&A and is intended to focus on, and provide context to, the quantitative disclosure in the tables. The SEC included the following examples of factors to be addressed:

- the material terms of employment agreements or arrangements, whether or not written;
- the material terms of awards and modifications thereof; and
- the waiver or modification of performance criteria.

The SEC deferred action on, and re-proposed for comment, the proposed rules that would require the disclosure of total compensation paid to up to three employees who are not executive officers if they “exert significant policy influence” at the company, a significant subsidiary or a principal business unit, division or function for the company and their compensation exceeded the compensation of any of the named executive officers. These employees need not be identified, but their job descriptions must be described. The SEC explained that such employees exert significant policy influence by having “responsibility for significant policy decisions” and cited as examples, the director of the news division of a major network, the principal creative leader of the entertainment function of a media conglomerate or the head of a principal business unit developing a significant technological innovation. By contrast, the SEC cited as excluded from potential disclosure highly-paid individuals such as traders, portfolio managers, salespersons, entertainment personalities, and professional athletes (among others) who are not responsible for significant policy decisions or broad-based management. The SEC seeks further comments as to whether this disclosure requirement should be limited to large accelerated filers (generally those with market capitalization of $750 million or above).

**Named Executive Officers**

Compensation disclosure is required for a company’s principal executive officer and principal financial officer (including, in each case, all persons who served in such capacity during the fiscal year), and the three most highly-compensated executive officers based on total compensation (subject to a $100,000 minimum), as the officers for which compensation disclosure is required. As was the case prior to these amendments, up to two additional individuals for whom disclosure would have been required but for the fact they were no longer serving as executive officers at the end of the last completed fiscal year must also be included.

**NEW DISCLOSURES REQUIRED**

**Severance and Change in Control**

The amended rules revise the requirements for additional narrative disclosures with respect to severance or change-in-control benefits, specifically the estimated payments and benefits that would be provided in each termination circumstance. The amended rules require a description of the circumstances that would trigger payments, along with quantitative disclosure of:

- amounts to be paid, based on reasonable estimates in the event of uncertainties, and
- a description of material conditions (such as non-compete agreements) to the receipt of such payments.

Disclosure is also required for material conditions or obligations tied to post-employment payments (e.g., non-compete, non-solicitation, non-disparagement, and confidentiality covenants).

**Perquisites**

The amended rules require disclosure of perquisites and personal benefits. Those having an aggregate value in excess of $10,000 (reflecting a reduction from the current $50,000 threshold) will require disclosure that identifies them on an itemized basis. To that end, under the amended rules, unless the aggregate value is less than $10,000, each perquisite or other personal benefit must be identified, and if any such item exceeds the greater of $25,000 and 10% of the total amount of perquisites and personal benefits, it must be quantified. The SEC emphasized that perquisites must be described in a manner that identifies the particular motive of the benefit received, so that categorizing as “travel and entertainment” company provided clothing, jewelry, artwork, theatre tickets and housekeeping services would not be appropriate.

The SEC has provided interpretive guidance as to what constitutes a perquisite or personal benefit. Among the factors to be considered are the following:

- An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive’s duties (e.g., a blackberry or laptop computer which facilitates work conducted outside the office).
- 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 emphasized that the analysis of what constitutes a perquisite “draws a critical distinction between an item that a company provides because the executive needs it to do the job, making it integrally and directly related to the performance duties, and an item provided for some other reason, even where that other reason can involve both company benefit and personal benefit.” The fact that an expense is treated as an “ordinary” or “necessary” business expense for tax or other purposes, or is for the benefit or convenience of the company is not dispositive. The business purpose or convenience of an item does not affect its characterization as a perquisite unless it is integrally and directly related to performance of the executive’s job. The fact that a company may provide, for example, security services or for security reasons require the use of company aircraft for personal travel with valid business purposes in mind does not affect the conclusion that the item is a perquisite or personal benefit.\(^1\)

The SEC retained the incremental cost methodology for valuing the cost of perquisites, but added an additional requirement for footnote disclosure of the methodology used to compute incremental costs. The SEC specifically noted that the amount attributed to perquisites for federal income tax purposes is not necessarily the incremental cost for disclosure purposes.\(^2\)

**Practice Tip:** Revisit how the company has previously valued perquisites to make sure it conforms to the incremental cost methodology. Accounting personnel should start detailing for eventual disclosure the methodology employed to compute the incremental cost of perquisites provided by the company.

### Gross Ups

The amended rules require tax reimbursement or gross ups to be specifically identified, and if they exceed $10,000, they must be quantified, even if they relate to perquisites that need not be identified because the total of such items is below $10,000.

### DISCLOSURE OF PLEDGED SHARES

Footnote disclosure to the beneficial ownership table, reflecting the number of shares pledged as security by named executive officers, directors and director nominees, is now required. To the extent shares are used as collateral, they may be subject to material risk or contingencies which have the potential to influence management’s performance and decisions. This disclosure is not required with respect to ownership by significant shareholders who are not members of management, other than pledges that may result in a change in control, which currently require disclosure.

**Practice Tip:** Update officer and director questionnaires to request information on pledged shares. Consider potential impact on securities held in margin accounts.

#### RELATED PERSON TRANSACTIONS

The rules as amended include significant revisions to Item 404 of Regulation S-K entitled “Certain Relationships and Related Transactions,” although the general purpose of the Item remains the same. These revisions were designed to make the certain relationships and related transactions disclosure requirements clearer and easier to follow. The principles for disclosure of related party transactions that were previously specified in Item 404(a) have been retained but the instructions that served to delineate what transactions are reportable or excludable based on bright lines have been removed. In general, the instructions for Item 404(a) explain:

- the related persons covered;
- the scope of the transactions covered;
- the method for computation of the amount involved;
- special requirements regarding indebtedness;
- the interaction with Item 402;
- the materiality of certain interests; and
- circumstances in which disclosure need not be provided

**General Disclosure for Related Person Transactions**

Item 404(a) articulates a broad principle for disclosure, and removes the distinction between indebtedness and other types of related person transactions. It provides for the disclosure of any transaction since the beginning of the last fiscal year\(^3\), or any currently proposed transaction:

- in which the company was or is to be a participant (not just a party);
- in which the amount involved exceeds $120,000 (increased from $60,000); and
- in which any related person had, or will have, a direct or indirect material interest at any time during the fiscal year.

Once the disclosure is triggered, the following must be described:

- the person’s name and relationship to the company;
- the person’s interest in the transaction, including the related person’s position or relationship with the entity that has an interest in the transaction; and
- the approximate dollar value of the amount involved and of the related person’s interest in the transaction.
Use of Certain Defined Terms

“Transaction” broadly includes but is not limited to, any financial transaction, arrangement or relationship or any series of similar transactions, arrangements or relationships. It specifically includes indebtedness and guarantees of indebtedness.

“Related Person” means (i) any person who was a director or executive officer or his or her immediate family members and, if disclosure is to be included in a proxy statement relating to the election of directors, any nominee for director and the immediate family members of such nominee if any such person was a “related person” during any part of the year; and (ii) a security holder beneficially owning more than 5% of any class of voting securities or any immediate family member of such person if any such person was a “related person” at the time the transaction occurred or existed.

“Immediate Family Member” is the same as the former definition except that it includes stepchildren, stepparents and any person (other than a tenant or employee) sharing the household of the related person.

“Amount Involved” means the dollar value of the transaction or series of similar transactions and includes (i) in the case of any lease or transaction requiring periodic payments or installments, the aggregate amount due on or after the beginning of the last fiscal year (including optional payments due at conclusion) and (ii) in the case of indebtedness, the largest aggregate amount outstanding (and all interest payable) at any time since the beginning of the last fiscal year.

Exceptions to Disclosure

Item 404(a) includes certain exceptions to disclosure. Disclosure is not required in connection with

- compensation to an executive officer if it is reported pursuant to Item 402; or if the executive is not an immediate family member of a related person, such compensation would have been reported under Item 402 if the executive officer was a named executive officer and such compensation was approved or recommended to the board for approval, by the compensation committee;
- compensation to a director if reported pursuant to item 402(k);
- indebtedness due for purchase of goods and services subject to usual trade terms, for ordinary business travel and expense payments and for other transactions in the ordinary course of business;
- a transaction involving indebtedness where the lender is a bank, savings and loan association or broker-dealer extending credit under Federal reserve Regulation T and the loans are not disclosed as nonaccrual, past due, restructured or potential problems; in such a case, disclosure can consist of a statement that the loan satisfied the following conditions:
  — it was made in the ordinary course;
  — it was made on substantially the same terms, including interest rate and collateral as those prevailing at the time for comparable loans with persons not related to the lender; and
  — it did not involve more than the normal risk of collectibility or present other unfavorable features.

- any transaction where the rates or charges invoiced are determined by competitive bids or involves services as a common or contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority;
- a transaction involving services as a bank depository of funds, transfer agent, registrar, trustee under a trust indenture or similar services; and
- a transaction involving services as a bank depository of funds, transfer agent, registrar, trustee under a trust indenture or similar services;
- a transaction where the interest of the related person arises solely from the ownership of a class of equity securities of the company and all holders of that class received the same benefits on a pro rata basis.

In addition, a person who has a position or relationship with an entity that engages in a transaction with a company will not be deemed to have an indirect material interest if:

- the interest arises only (i) from the person's position as a director of another corporation that is party to the transaction; or (ii) from direct or indirect ownership by such person and all other related persons, in the aggregate, of a less than 10% equity interest in another person which is a party to the transaction; or (iii) from both such position and ownership; or
- the interest arises only from the person's position as a limited partner in a partnership in which the person and all other related persons, have an interest of less than 10%, and the person is not a general partner of and does not have another position in the partnership.

Company Policies and Procedures for Approval of Related Person Transactions

The amendments require a description of the company's policies and procedures for the review, approval or ratification of transactions with related persons that are reportable under Item 404(a). The description must include the material features of these policies and procedures that are necessary to under-
stand them. Although the material features of such policies and procedures will vary from company to company, examples of disclosure may include:

• the types of transactions covered and standards applied;
• the persons or groups of persons on the board who are responsible for oversight; and
• whether such policies and procedures are in writing and if not, how they are evidenced.

Companies must also identify any transaction required to be disclosed under Item 404(a) where the company's policies did not require review or where such policies were not followed. However, this disclosure need not be provided with respect to any transaction that occurred at a time before the related party had the relationship that would trigger disclosure if the transaction did not continue after the related person had that relationship.

**Promoters and Control Persons**

As proposed and adopted, the amendments require disclosure regarding the identity of promoters and the company's transactions with those promoters if the company had a promoter at any time during the last five fiscal years. This disclosure is required to be included in long-form registration statements under the Securities Act and Exchange Act. The required disclosure includes:

• the names of the promoters;
• the nature and amount of anything of value received by each promoter from the company and the nature and amount of any consideration received by the company; and
• additional information regarding any assets acquired by the company from a promoter.

The same disclosure is required for any person who acquired control, or is part of a group that acquired control, of an issuer that is a shell company.

**Corporate Governance Disclosure**

Existing and new disclosure requirements regarding director independence and related corporate governance disclosure have been consolidated under a single item – new Regulation S-K Item 407.

**Director Independence**. Currently, listed companies are required to determine whether their directors and committee members are independent based on definitions they adopt, which at a minimum must comply with the applicable listing standards. The amended rules require companies:

• to identify each director and director nominee that is independent (including for any person who served as a director during any part of the year), and each member of the compensation, nominating or audit committee that the board has not identified as independent;
• if a company uses its own definition of independence, to disclose whether that definition is published on the company's website, or include the definition as an appendix to the company's proxy materials at least once every three years or if the policies have been materially amended since the beginning of the last fiscal year; and
• for those directors identified as independent, to include a description, by specific category (so that the nature of the transaction is readily apparent but without specific detail) of any transactions, relationships or arrangements not disclosed pursuant to Item 404(a) that were considered by the board of directors in determining that the applicable independence standards were met.

Information on director independence is required in a proxy statement for any person who served as a director during any part of the year even if the person no longer serves as a director at the time of filing the registration statement or report, or if the director's term of office will not continue after the meeting to which the proxy statement relates.

**Compensation Committees**. Under the current rules, certain disclosure is required with respect to audit and nominating committees. The amended rules require similar disclosure with respect to compensation committees, retain disclosure regarding compensation committee interlocks, and require disclosure describing the company's processes and procedures for the consideration and determination of executive and director compensation, including:

• whether the compensation committee has a charter, and if so, the web site address at which a current copy is available, and if not so available, attaching a copy of the charter;
• the scope of authority of the compensation committee;
• the extent to which the compensation committee may delegate its authority, specifying what authority may be delegated to whom;
• any role of executive officers in determining or recommending the amount or form of executive officer or director compensation; and
• any role of compensation consultants in determining or recommending the amount or form of executive officer or director compensation, identifying the consultants,
stating whether they are engaged by the compensation committee directly or any other person, describing the nature and scope of their assignment, the material elements of the instructions or directions given and identifying any executive officer the consultants contacted in carrying out their assignment.

**PLAIN ENGLISH**

Disclosure of executive compensation, beneficial ownership, related person transactions and corporate governance matters are required to be provided in plain English in order to make the disclosure easier to read and understand. However, the plain English requirements have not been extended to the entire proxy statement.

**CHANGES TO FORM 8-K RULES**

The SEC also made modifications to the Form 8-K Current Report requirements for compensatory and officer and director matters which will be addressed in a separate forthcoming Paul Hasting's client alert.

**EFFECTIVE DATES/PHASE-IN**

For Forms 10-K and 10-KSB, compliance is required for fiscal years ending on or after December 15, 2006, and for proxy and information statements and registration statements covering registrants other than registered investment companies, compliance is required for any proxy or information statement or registration statement filed on or after December 15, 2006, that are required to include Item 402 and 404 disclosure for fiscal years ending on or after December 15, 2006.

The revised Summary Compensation Table and related person transaction disclosure requirements will be phased-in, so no re-statement of prior disclosures will be required. Disclosure will be required only for the most recent fiscal year, resulting in phased-in implementation over three years.

**ACTIONS TO CONSIDER**

We suggest the following steps be undertaken to prepare the company for compliance for the 2007 proxy season:

Step (1): A working group should be established (if one has not already been established) to serve as the point persons for the company's response to the new disclosure regime.

Step (2): The working group should:

- Undertake a review of the director and executive compensation and decision-making process in light of the various matters that must be addressed under the rules.
- Educate the compensation committee as to the new requirements, particularly the disclosures required in the CD&A and the potential for greater scrutiny of committee decisions and policies.
- Gather and review peer data and other information concerning all of the new or enhanced disclosure items, including overall compensation. Engage compensation counsel (or consultants) to assist and advise the company in analyzing the data and other information.
- Start work now on the CD&A, total compensation and related narrative disclosure required under new rules.

Step (3): Whereupon review current policies and practices may potentially fall short of what would be considered generally acceptable, consider adopting new policies and practices for future compensation decisions.

**NOTES**

1. The SEC outlined as examples of items requiring disclosure as perquisites or personal benefits under Item 402 the following: club memberships not used exclusively for business entertainment purposes, personal financial or tax advice, personal travel using vehicles owned or leased by the company, personal travel otherwise financed by the company, personal use of other property owned or leased by the company, housing and other living expenses (including but not limited to relocation assistance and payments for the executive or director to stay at his or her personal residence), security provided at a personal residence or during personal travel, commuting expenses (whether or not for the company's convenience or benefit), and discounts on the company's products or services not generally available to employees on a non-discriminatory basis.
2. The SEC explained that the cost of personal use of corporate aircraft imputed to an employee under the IRS' Standard Industry Fare Level rules is not generally the incremental cost of such perquisite for disclosure purposes.
3. Disclosure in registration statements is still required for three years.
Ms. Brower is a member and Mr. Zuppone is Co-chair of Paul Hastings’ Securities and Capital Markets Practice Group, and Mr. Poerio is Co-chair of Paul Hastings’ ERISA Practice Group.

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