

SEC Proposes Revisions to Executive Compensation Disclosure and Related Areas

On January 27, 2006, the Securities and Exchange Commission (the "Commission") proposed significant revisions to the executive compensation disclosure and related matters of public companies. The revisions represent the first major overhaul of executive compensation disclosure since 1992. The Commission's goal is for the new rules to provide clearer and more complete compensation disclosure. Since these proposed rules are very broad and encompassing, boards of directors and compensation committees should become familiar with the proposed rules. Because the rules are expected to be effective by the 2007 proxy season, reporting on 2006 compensation, boards of directors and compensation committees should determine what actions they should consider taking in 2006 in light of the expected final rules and the possible reaction of the investment community to certain of the revised executive compensation disclosures.

Although the proposals are in the comment period and most likely will not be in final form for a few months, the Commission did provide interpretations regarding perquisites and other personal benefits which are applicable to current disclosure relating to this area.

Guidance Affecting Current Disclosure

Updated Guidance on Perquisites and Other Personal Benefits

Although the revised disclosure rules are only proposed and are in the comment period, the Commission did provide updated guidance on the area of perquisites and other personal benefits which applies to disclosure under the current rules.

- **Items that are not perquisites or other personal benefits.**


The Commission clarified that items are not perquisites or other personal benefits if the items are integrally and directly related to the performance of the duties of the named executive officer ("NEO"). The following items are not perquisites or other personal benefits:

- Office space at a company business location;
- Close reserved parking space;
- Additional clerical or secretarial services devoted to company matters;
- Travel to and from business meetings;
- Other business travel;
- Business entertainment;
- Security during business travel; and
- Itemized expense accounts, the use of which is limited to business purposes.

- **Items that are perquisites or other personal benefits.**

The Commission also clarified items that are perquisites or other personal benefits which, depending on the aggregate amount, would be disclosable under the current rules. Items are perquisites or other personal items if they confer a direct or indirect benefit that has a personal aspect regardless of whether the items provide a business reason or convenience to the company unless the items are generally available on a non-discriminatory basis to all employees. The following items are perquisites or other personal benefits:

- Company provided aircraft, yachts or other watercraft;
- Commuter transportation services;
- Additional clerical or secretarial services devoted to personal matters;
- Investment management services;
- Club memberships not exclusively used for business entertainment;



This alert is for informational purposes only and is not intended to be legal advice. Transmission is not intended to create and receipt does not establish an attorney-client relationship. Legal advice of any nature should be sought from legal counsel. For more information about Haynes and Boone and our practices, please visit www.haynesboone.com

- 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 executives to stay at his or her personal residence);
- Security provided at a personal residence or during personal travel; and
- Discounts on the company's products or services that are not generally available to employees on a non-discriminatory basis.

Highlights of Proposed Rules

Expanded Named Executive Officers

The proposed rules expand the list of NEOs to the following:

- Any Principal Executive Officer who served during the last fiscal year even if not serving at the end of the last fiscal year;
- Any Principal Financial Officer who served during the last fiscal year even if not serving at the end of the last fiscal year;
- The three most highly compensated executive officers (based on total compensation for the year and not just based on annual salary and bonus as is currently the case) serving as executive officers at the end of the last fiscal year with total compensation of at least \$100,000; and
- Up to two other persons who would have been among the three most highly compensated executive officers had they remained executive officers at the end of the last fiscal year.

It is also proposed that the total compensation for up to three non-executive officer employees (but not the names of the employees) be included in a narrative disclosure if the total compensation of any such non-executive officer for the last fiscal year exceeded the total compensation of any of the NEOs.

New Compensation Discussion and Analysis Section

The proposed rules would eliminate the current compensation committee report and performance graph and add a Compensation Discussion and Analysis ("CD&A") Section where companies would set forth the material principles underlying their executive compensation policies and the most important factors relevant to the analysis of these policies. The CD&A would include the following information:

- The objectives of the compensation programs;
- What the compensation programs are designed to reward and not reward;
- All elements of compensation;
- Why the company elects to pay each element of compensation;
- How the company determines the amount of each element; and
- How each element and the company's decisions regarding that element fit the company's overall compensation objectives and affect the decisions regarding other elements of compensation.

Expanded Summary Compensation Table

The proposed rules expand and modify the Summary Compensation Table which would include the following columns for the NEOs for the last three fiscal years:

- New Total Compensation Column which would be the total of the other columns;
- Salary Column, including earned but deferred salary;
- Bonus Column, including earned but deferred bonus;

This alert is for informational purposes only and is not intended to be legal advice. Transmission is not intended to create and receipt does not establish an attorney-client relationship. Legal advice of any nature should be sought from legal counsel. For more information about Haynes and Boone and our practices, please visit www.haynesboone.com

- Stock Awards Column based on the issuance of equity securities, restricted stock, restricted stock units, phantom stock, phantom stock units and common stock equivalents using the grant date fair value of the awards and including a footnote on all earnings during the year on outstanding stock awards;
- Option Awards Column based on options and stock appreciation right grants using the grant date fair value of the awards and including a footnote on all earnings during the year on outstanding option awards;
- Non-Stock Incentive Plan Compensation Column where the performance measure under an incentive plan is not based on the price of the company's equity securities or the award is not settled by the issuance of the company's equity securities and the column would include earnings on outstanding awards; and
- All Other Compensation Column which would include all compensation not included under another column, including the following:
 - All items that are currently included under the "Other Annual Compensation" column;
 - Except for perquisites and other personal benefits described below, all items equal to or less than \$10,000 in value would be included in the total amount of the column but would not be specifically identified;
 - All items greater than \$10,000 in value would be separately identified and the amount disclosed in a footnote;
 - All earnings on compensation that are deferred on a non-tax qualified basis, including non-tax qualified defined contribution retirement plans (currently, these earnings only need to be noted when they are above market or preferential);
 - The increase in actuarial value of defined benefit and actuarial plans accrued during the year;
 - All perquisites and other personal benefits would be included and identified unless the aggregate of them is less than \$10,000, with additional disclosure of the value of all perquisites and other personal benefits valued at the greater of \$25,000 or 10% of all the perquisites and other personal benefits;
 - All amounts paid or accrued pursuant to a plan or arrangement in connection with any termination of employment or change of control;
 - Annual company contributions and all other allocations to vested and unvested defined contribution plans;
 - Any life insurance premiums paid by the company for life insurance on any NEO;
 - Gross ups or other reimbursement amounts paid for the payment of taxes; and
 - The compensation cost for any security of the company purchased from the company at a discount through the deferral of fees or otherwise unless the discount is available to all security holders or to all salaried employees of the company.

Two New Supplemental Tables

The proposed rules propose two new supplemental tables to follow the Summary Compensation Table:

- Grants of Performance Based Awards Table which would cover for the last fiscal year all non-stock grants of incentive plan awards, stock-based incentive plan awards and awards of options and restricted stock under plans that are performance based; and
- Grants of All Other Equity Awards Table which would cover for the last fiscal year all equity compensation awards that are not performance based, such as stock grants and stock options where the payout or future value is tied to the company's stock price and not to other performance criteria.

Other Tables

The proposed rules propose four additional tables:

- Outstanding Equity Awards at Fiscal Year-End which would include the market based values at the fiscal year-end of stock option plans, stock appreciation right plans, restricted stock plans and incentive plans;
- Options Exercises and Stock Vesting which would include the amounts received upon exercise of options or the vesting of stock during the last fiscal year;

- Retirement Plan Potential Annual Payments and Benefits which would replace the current pension plan table, alternative plan disclosure and certain other narrative description and provide estimated annual retirement payments under defined benefit plans for NEOs and disclose each plan in which NEOs participate that provides for the payment of specific retirement benefits or benefits that will be paid primarily following retirement; and
- Nonqualified Defined Contribution and Other Deferred Compensation Plans which would disclose the contributions, earnings and balances under nonqualified defined contribution and other deferred compensation plans.

Disclosure of Potential Post-Employment Payments

The Commission has proposed narrative description of any arrangements for payments at, following or in connection with the resignation, severance, retirement or other termination of NEOs, changes in the responsibilities of NEOs or a change in control.

Director Compensation Table

The Commission has proposed a new table covering the total compensation of directors for the last fiscal year which would include the following columns:

- Total Compensation Column which would be the total of the other columns;
- Fees Earned or Paid in Cash Column;
- Stock Awards Column;
- Option Awards Column;
- Non-Stock Incentive Plan Compensation Column; and
- All Other Compensation Column.

The instructions to the Summary Compensation Table for NEOs would apply to the Director Compensation Table where applicable. If all the directors have the same amounts under each column, then only one row need be completed for all the directors.

Revised Form 8-K

The proposed rules would add a new section to Item 5.02 of Form 8-K and move employment compensation arrangements from Item 1.01 to Item 5.02. The safe harbor for Item 1.01 would apply for Section 10(b) and Rule 10b-5 liability and Form S-3 eligibility for the late filing of the new Item 5.02 information. In addition, it is proposed that Item 1.01 does not need to be included in a Form 8-K disclosure if the substantive disclosure that would be included in Item 1.01 is included under other items in the Form 8-K. However, the opposite is not true as Item 1.01 disclosure does not excuse disclosure under other applicable Form 8-K items.

Revised Item 404 of Regulation S-K


It is proposed that Item 404 be revised as follows:

- Item 404(a) would cover all related party transactions, including loans, with the new threshold amount being \$120,000 rather than \$60,000 and would include all related persons that have a direct or indirect material interest in the transactions;
- Item 404(b) would disclose the policies and procedures for the review, approval or ratification of related party transactions covered by Item 404(a); and
- Item 404(c) would require the identification of promoters and the disclosure of transactions with such promoters during the last five years in filings on Form S-1, Form SB-2, Form 10 and Form 10-SB.

New Item 407 of Regulation S-K

The Commission proposed that a new Item 407 be added regarding Corporate Governance as follows:

- All independent directors and independent director nominees would be identified;



This alert is for informational purposes only and is not intended to be legal advice. Transmission is not intended to create and receipt does not establish an attorney-client relationship. Legal advice of any nature should be sought from legal counsel. For more information about Haynes and Boone and our practices, please visit www.haynesboone.com

- All compensation, nominating and audit committee members that are not independent would be identified;
- For each independent director, there would be a description of any transactions, relationships or arrangements that are not disclosed under Item 404(a) that were considered by the board in determining independence;
- There would be revised audit and nominating committee disclosure to eliminate duplication and update the disclosure regarding the audit committee charter; and
- The processes and procedures for consideration and determination of executive and director compensation would be disclosed.

Miscellaneous

Other items included in the proposal including the following:

- Item 402 vs. Item 404 – Item 402 rather than Item 404 would include all disclosure of transactions in which the primary purpose is to furnish compensation to the NEO;
- Pledged Shares – Item 403(b) of Regulation S-K would require the disclosure of the number of shares of company stock pledged by the NEOs, the directors and the director nominees and require the inclusion of any director qualifying shares in the aggregate share ownership of each director;
- Plain English – The Plain English rules would apply to most of the subjects covered by the proposed rules; and
- Other Issuers – There are certain variations and limitations regarding the application of the proposed rules to Small Business Issuers, Foreign Private Issuers and Business Development Companies.

If you should have any questions regarding these proposed rules, please contact any of the following members of the Public Companies Practice Group.

Brian D. Barnard
(817) 347-6605
brian.barnard@haynesboone.com

Christopher E. Kirkpatrick
(214) 651-5447
chris.kirkpatrick@haynesboone.com

Janice V. Sharry
(214) 651-5562
janice.sharry@haynesboone.com

Arthur S. Berner
(713) 547-2526
arthur.berner@haynesboone.com

Bryce D. Linsenmayer
(713) 547-2007
bryce.linsenmayer@haynesboone.com

W. Scott Wallace
(214) 651-5587
scott.wallace@haynesboone.com

William L. Boeing
(972) 680-7553
william.boeing@haynesboone.com

Judithe Little
(713) 547-2235
judithe.little@haynesboone.com

Tom Yang
(214) 651-5545
tom.yang@haynesboone.com

Michael M. Boone
(214) 651-5552
michael.boone@haynesboone.com

W. Bruce Newsome
(214) 651-5119
bruce.newsome@haynesboone.com

Guy Young
(713) 547-2081
guy.young@haynesboone.com

Garrett DeVries
(214) 651-5614
garrett.devries@haynesboone.com

David H. Oden
(972) 739-6929
david.oden@haynesboone.com

William R. Hays, III
(214) 651-5561
bill.hays@haynesboone.com

Gregory R. Samuel
(214) 651-5645
greg.samuel@haynesboone.com



This alert is for informational purposes only and is not intended to be legal advice. Transmission is not intended to create and receipt does not establish an attorney-client relationship. Legal advice of any nature should be sought from legal counsel. For more information about Haynes and Boone and our practices, please visit www.haynesboone.com