



This publication is one of many Orrick publications designed to provide our clients and contacts with information they can use to more effectively manage their businesses and access Orrick's expertise. Please contact [Meg Hamilton](#) for information on our other publications.

You are receiving this communication because we believe you have an existing business relationship with or have previously indicated your desire to receive such communications. You may unsubscribe using the link below. unsubscribe@orrick.com

January 17, 2006

SEC MARCHES FORWARD WITH PROPOSALS TO EXPAND EXECUTIVE COMPENSATION DISCLOSURE

Today, January 17, 2006, the Securities and Exchange Commission (the "SEC") proposed sweeping reforms aimed at increasing public companies' disclosure of the compensation and benefits they pay to their executive officers and directors. The SEC also approved other proposals relating to disclosure of related party transactions, director independence and other corporate governance matters and modification of the Form 8-K requirements for reporting compensation arrangements. The proposals would change the disclosure required in proxy statements, Annual Reports on Form 10-K and registration statements.

Background

The proposals, developed at the direction of new SEC Chairman Christopher Cox, respond to a torrent of criticism from investors that the current executive compensation disclosure regime, last revamped by the SEC in 1992, fails to provide investors with clear and understandable disclosure of compensation amounts, philosophies and practices. Underlying this criticism, of course, is growing investor concern that executive compensation today is excessive and poorly aligned with the interests of shareholders. While much of the sound and fury today is similar to the investor outcry that preceded the last round of SEC rule changes almost 14 years ago, the recent increase in the number of shareholder proposals and lawsuits concerning executive compensation indicates an unprecedented investor commitment to dramatically changing current executive compensation practices. And it is that highly visible commitment that has led Chairman Cox to stake out executive compensation disclosure reform as a top policy priority for the SEC.

Executive Officer and Director Compensation Disclosure

If approved in their proposed form, the rules would require:

- Three years of compensation disclosure for the principal executive officer, the principal financial officer and the three other most highly compensated executive officers based on total compensation, plus the title and amount of compensation without names for up to three other non-officers if their total compensation would exceed the total compensation of any of the five named executive officers;

- A Summary Compensation Table that includes:
 - Total annual compensation column for the company’s named executive officers;
 - Annual salary and bonus;
 - The dollar value of stock-based grants to the company’s named executive officers (the table currently requires only the number of shares), based on the grant date fair value as calculated under SFAS 123R;
 - Cash incentive awards not tied to stock performance, which would be reflected in the year when the performance measure is satisfied and payment is earned; and
 - “All Other Compensation,” which would include such things as increases in the actuarial value of defined benefit plans, company contributions, earnings on deferred compensation that is not tax-qualified, tax gross-up payments and perquisites totaling more than \$10,000 annually (the current threshold for perquisites is the lesser of either \$50,000 or 10% of the executive’s total annual salary and bonus);
- A new Compensation Discussion and Analysis section in the proxy statement, which would require a discussion of the company’s strategy in fixing executive pay, including the objectives and the elements, why each is important, how each is determined and how each fits into the overall compensation strategy (replacing the Compensation Committee Report and the Performance Graph);
- A Grants of Performance-Based Awards table detailing all stock and non-stock performance based awards;
- A Grants of All Other Equity Awards table;
- An Outstanding Equity Awards at Fiscal Year-End table showing outstanding awards representing potential future receipts;
- An Option Exercises and Stock Vested table disclosing the amounts realized on equity compensation during the last year, the amount of vested and unvested options, grant date, exercise price and the fair value on grant date;
- A Retirement Plan Potential Annual Payments and Benefits table detailing annual benefits payable to the named executive officers;
- A Nonqualified Defined Contribution and Other Deferred Compensation Plans table disclosing executive contributions, company contributions, aggregate earnings and withdrawals in the last fiscal year and the total balance at the end of the year;
- Disclosure of any arrangement that provides for post-employment benefits, including perquisites, in connection with the termination of any named executive officer, change in responsibility or change in control of the company, including the estimated payments and benefits; and

- A Director Compensation table, similar to the Summary Compensation Table, but showing one rather than three years of compensation.

Related Person Transactions, Director Independence and Other Corporate Governance Matters

The proposed rules would:

- consolidate disclosures relating to director independence into one section of the proxy statement, add disclosure relating to compensation committees similar to the current audit committee and nominating committee disclosure requirements, and require companies to disclose any relationships that the board considered in determining whether a director is independent; and
- require companies to disclose the policy for approving related party transactions, increase the reporting threshold for such transactions from \$60,000 to \$120,000 and amend the disclosure requirements relating to officer and director indebtedness in light of the Sarbanes-Oxley Act of 2002.

Form 8-K, Plain English Disclosure and Security Ownership

Under the proposed rules:

- Form 8-K would be amended to capture additional employment arrangements and material amendments thereto involving named executive officers;
- most executive compensation disclosures must be in “Plain English;” and
- disclosure must be made of the number of shares pledged by management.

Effective Date

The proposed rules are expected to be available shortly, with comments due in 60 days after publication in the Federal Register. The rules will probably not be final and effective until the 2007 proxy season at the earliest. Press reports suggest, however, that many corporate-governance-conscious companies will comply with some or all of the proposed rules in their 2006 proxy statements.

Coming Attractions

Be on the lookout for more Client Alerts on this topic that will, among other things, provide an in-depth summary of the proposed rules and pragmatic, “what to do now” advice for Compensation Committee members.



Contact Us

Members of Orrick's Compensation & Benefits, Corporate, and Securities Litigation teams are available to assist you with questions regarding the various aspects of the new SEC proposals.

The contents of this publication are for informational purposes only and are not meant nor should be construed to be legal advice. No responsibility is assumed for errors made in the publishing process.

© 2006 Orrick, Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Orrick as the author. All other rights reserved.