

## SEC'S NEW YEAR'S RESOLUTION: MAKE COMPANIES REDRAFT THE 2007 PROXY STATEMENT

December 28, 2006

To Our Clients and Friends:

'Twas virtually the night before Christmas, but the SEC was stirring and re-wrote the executive compensation disclosure rules applicable to equity awards (yet again). You may have heeded conventional wisdom and, before going on vacation, prepared an initial draft of the 2007 proxy statement based on the “final” rules issued in October. However, like the shirt you bought for that impossible to please relative, now that the SEC released what it calls new “interim final” rules, you will need to take that draft back and redesign a couple of key tables.

The principal effect of the new rule is to more closely conform the dollar amount of equity based compensation reported in the Summary Compensation Table to the related expense reflected in the financial statements under FAS 123R. Not surprisingly, rather than just changing the way the awards are reported in the Summary Compensation Table, the interim final rules require reporting the same equity awards in even more different ways and different places in the required disclosure.

### NEW RULES APPLY TO AWARDS GRANTED BEFORE 2006

The new rules are effective immediately upon publication in the Federal Register and apply to (i) awards that were granted or materially modified during or after 2006, (ii) outstanding equity awards granted *before* 2006, to the extent such awards were not fully vested before 2006 and (iii) outstanding awards granted *before* 2006 if such awards will be settled in cash or otherwise do not transfer the risk of share ownership to the employee (“liability” awards).

For the 2007 proxy statement, this means that you will need to collect and report additional equity compensation information from years *prior* to 2006 and you will need to re-compute the amount of equity compensation from 2006 that must be reported. You should do this for **all executive officers** because, in light of the changes described below, you will need to re-determine which officers are the named executive officers. That is, these changes will likely change the amounts reported in the Summary Compensation Table with respect to stock awards and stock options, and therefore could change who among your executive

officers other than the CEO and CFO are the highest paid officers on the basis of Total Compensation.

## CHANGES TO THE RULES

Disclosure Consistent with FAS 123R. Under the new rules, the dollar value of the compensation cost associated with the awards disclosed in the Stock Awards and Option Awards columns of the Summary Compensation Table and the Directors Compensation Table must now be computed in a manner consistent with FAS 123R. (Unlike FAS 123R, the prior final rules required disclosure of the full dollar value of the award in the year of grant.)

The amount to be disclosed and timing of disclosure depends on whether the award is treated as a “liability” or “equity” award for FAS 123R purposes; any changes in the fair value of a “liability” award must be disclosed each year during the term of the award and the fair value of an “equity” award, determined as of the date of grant, must be spread over the applicable vesting period. Accordingly, (i) if vesting of an equity award is based on the passage of time, the compensation charge must be spread over that time period and (ii) if vesting of the award is based on the achievement of performance conditions, a proportionate amount of the compensation charge (based on service performed) must be disclosed only if and when the achievement of the performance criteria is or becomes “probable.” If the executive is eligible to retire and can retain the equity award upon retirement regardless of the period of service completed, the full compensation charge must be disclosed for the year of grant (instead of over the vesting period).

Special rules apply in respect of awards granted prior to 2006, when companies were first required to comply with FAS 123R. With regard to both equity awards that had not vested and liability awards that have not been settled at that time, the SEC is requiring that companies use the FAS 123R “modified prospective transition method” for purposes of these disclosure rules, regardless of whether such companies adopted that method for financial statement reporting purposes. This means that, for those companies that have not adopted this method, the amounts reported in the Summary Compensation Table in respect of pre-2006 awards will differ from the financial accounting charges reported in the corresponding year with respect to such awards.

Any amount disclosed in a prior year is “reversed” if the award is forfeited or the achievement of performance criteria ceases to be “probable” during the most recently completed fiscal year. Reversing a previously disclosed amount could lead to the disclosure of a negative number in the Stock Awards and Option Awards columns, decrease the

amount disclosed in the “Total” column and/or cause the executive officer to fall out of the named executive officer group.

Disclose Full Value in the Grant of Plan-Based Awards Table and Footnote to Director Compensation Table. But to be sure that shareholders see every possible variation on how to value an equity award granted, the full dollar value of each award granted to the named executive officers during the prior year must also be disclosed in a new column to the Grant of Plan-Based Awards Table. (This information would have been disclosed in the Summary Compensation Table under the prior final rules instead of the incremental inclusion in that table as outlined above.) In addition, with limited exception, the incremental value of any repriced or materially modified option must be disclosed in a footnote to the Grant of Plan-Based Awards Table.

Similarly, to conform this disclosure for directors, the revised rules require footnote disclosure to the Director Compensation Table of the grant date fair value of each equity award calculated in accordance with FAS 123R.

Options issued instead of Salary or Bonus. The amount of salary and bonuses that is paid in a non-cash form, such as stock or options, at the election of the named executive officer, must be disclosed in the “Salary” or “Bonus” columns of the Summary Compensation Table, with a footnote referring to the Grants of Plan-Based Awards Table where the options or other non-cash awards are reported. (The replacement stock or options are not to be disclosed in the Stock Awards or Option Awards columns, as would have been required under the prior final rules and the rules in effect prior to the recent revisions.)

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If you have any questions or comments, please feel free to contact either of the undersigned.

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