

# Client Alert: SEC Proposes New Rules On Disclosure Of Equity Compensation Plan Information

On January 26, 2001, the SEC published for comment proposed amendments to the disclosure requirements under the Securities Exchange Act with respect to disclosure of equity compensation plan information.<sup>1</sup> The proposed amendments would require disclosure in a registrant's proxy statement or annual report on Form 10-K or Form 10-KSB of the following:

- the number of securities that have been authorized for issuance under each equity compensation plan of the registrant in effect at the end of the most recently completed fiscal year;
- the number of securities issued pursuant to equity awards made during the last completed fiscal year, plus the number of securities to be issued upon the exercise of options, warrants or rights granted during the last completed fiscal year, under each plan;
- the number of securities to be issued upon the exercise of outstanding options, warrants or rights under each plan; and
- other than securities to be issued upon the exercise of outstanding options, warrants or rights, the number of securities remaining available for future issuance under each plan.

The proposed disclosure requirements would apply to any equity compensation plan that provides for the award of a registrant's securities or the grant of options, warrants or rights to purchase the registrant's securities to officers, directors and employees of the registrant or its parent or subsidiary corporations, or to any other person. Individual arrangements that contemplate such awards or grants are also covered by the proposed rules, but may be aggregated and disclosed as a single item.

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<sup>1</sup>See Securities and Exchange Commission Release Nos. 33-7944, 34-43892; File No. S7-04-01. A copy of the Release is available on the SEC website at [www.sec.gov/rules/proposed/33-7944](http://www.sec.gov/rules/proposed/33-7944).

The required disclosure would be presented in a table set forth (1) in the registrant's proxy statement whenever stockholder approval of an equity compensation plan is sought; or (2) in the registrant's annual report on Form 10-K or Form 10-KSB in years where no such stockholder approval is sought. Registrants would be required to identify, either in the table or through a narrative statement, any equity compensation plans adopted without stockholder approval and to provide a brief, narrative description of the material features of any such plan adopted during the last completed fiscal year. Registrants would be required to provide this information regardless of whether the securities to be issued under the plan were authorized but unissued securities or repurchased or "treasury" shares.

#### Background

The proposed amendments have evolved out of growing concerns at the SEC about the impact of the increased use of equity compensation, particularly stock options. These concerns include:

- the absence of full disclosure to stockholders about equity compensation plans;
- the potential dilutive effect of equity compensation plans; and
- the adoption of many plans without the approval of stockholders.

Current rules require disclosure in a registrant's proxy statement of the material features of an equity compensation plan submitted for stockholder approval but do not require disclosure of the total number of securities that a registrant has authorized for issuance under its entire equity compensation program. The SEC has been urged to provide greater transparency of all equity compensation plans, irrespective of whether such plans have received stockholder approval, and believes that the proposed disclosure requirements would facilitate an investor's ability to evaluate the effect that equity compensation plans have on their stock ownership or to compare the equity compensation plans of a registrant with those of its competitors.

Moreover, the SEC has expressed significant concerns as to the dilutive potential of equity compensation plans from the standpoint of both economic and voting power because significant reallocation of ownership may result from the issuance of equity securities under these plans

Finally, the SEC believes that many equity compensation plans may not be subject to stockholder approval. At the state and federal levels, stockholder approval is not

mandatory, but is only required in a few jurisdictions or to qualify for favorable federal income tax treatment. Although there are rules of self-regulatory organizations that do require companies to obtain stockholder approval for some plans, the SEC believes that in many instances companies are able to avoid obtaining such approval through existing exceptions to the rules.<sup>2</sup> Consequently, some market participants have expressed concern that a growing number of plans escape stockholder scrutiny because they are not being submitted for approval.

#### Comments Sought

The staff of the SEC has requested comments as to the appropriateness of the proposed disclosure requirements, as well as the location of the proposed disclosure. Comments on the proposed amendments to the disclosure requirements should be submitted to the SEC on or before April 2, 2001.

#### For Additional Information

If you have any questions regarding the proposed amendments to the disclosure requirements, please contact:

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<sup>2</sup>We note that The New York Stock Exchange and The Nasdaq Stock Market are contemplating revising their rules regarding stockholder approval of stock option and other equity compensation plans.