

Client Alert

SEC Revises Disclosure Requirements for Equity-Based Compensation

On December 22, 2006, the SEC issued an unexpected release¹ amending its rules regarding disclosure of executive and director compensation that were adopted in July 2006.² The amendments revise the disclosure rules relating to stock and option awards by requiring disclosure in the Summary Compensation Table of only the proportionate amount of the award's total fair value that is recognized in the company's financial statements for the fiscal year. The amendments also add disclosure of the full grant date fair value of stock and option awards to the Grants of Plan-Based Awards Table. The compliance dates for the amendments are the same as those for the rules adopted in July 2006, so that the amended rules will apply to the 2007 proxy season.

Summary Compensation Table

FAS 123R Disclosure of Equity Awards

The new rules now require the dollar amount of compensation associated with stock and option awards disclosed in the Summary Compensation Table to reflect the amount recognized as compensation cost in respect of these types of awards for each named executive officer in the company's financial statements for the applicable year in accordance with Financial Accounting Standards No. 123 (revised 2004) *Share-Based Payment* (FAS 123R), whether or not the awards were granted to the officers in that year. As a result of these amendments, the amounts disclosed in the stock and option awards columns will include compensation cost recognized in the financial statements with respect to awards granted in previous fiscal years and the subject fiscal year. This is a significant departure from the prior rules. The prior rules required companies to disclose the full grant date value of stock and option awards in the Summary Compensation Table in the year of grant, irrespective of the compensation cost recorded in the company's financial statements that year with respect to the awards. That grant date value was also included in the calculation of total compensation in the year of grant under the prior rules. The amended rules, in certain circumstances, could affect the determination of which officers constitute the named executive officers for any year.

For equity awards that vest over time, this generally means that, consistent with FAS 123R, the amount reflected in the Summary Compensation Table in respect of these awards will be spread over the requisite service period. However, as required by FAS 123R, if the named executive

¹ See SEC Release Nos. 33-8765; 34-55009; File No. S7-03-06. A copy of the Release is available on the SEC's website at www.sec.gov/rules/final/2006/33-8765.pdf.

² For a discussion of the July 2006 amendments, see our Client Alert, "SEC Adopts Amendments to Executive Compensation and Related Person Transaction Disclosure Rules," available on our website at www.chadbourne.com/publications/index.html.

officer is eligible to retire and keep the award upon retirement regardless of the stated vesting terms, the full grant date value of the award must be recognized as compensation expense in the year of grant and similarly disclosed in the Summary Compensation Table.

In a departure from FAS 123R, the new rules provide that companies should disregard estimates of forfeitures related to service-based vesting conditions when calculating the amount of stock-based awards reported in the Summary Compensation Table and should instead assume that the named executive officer will satisfy the requisite service conditions. If the named executive officer fails to perform the requisite service and actually forfeits the award, the amount of compensation cost previously disclosed in the Summary Compensation Table will be deducted in the period during which the award is forfeited. Any forfeitures of stock or option awards during the year must be described in a footnote to the table.

Consistent with FAS 123R, performance-based awards will be disclosed in the Summary Compensation Table only if it is probable that the performance condition will be achieved. If the achievement of the performance condition is not probable at the grant date but becomes probable in a subsequent period, the proportionate amount of compensation cost based on service previously rendered will then be disclosed in the Summary Compensation Table. If the achievement of a performance condition was previously considered probable but in a later period is no longer considered probable, the amount of compensation cost previously disclosed in the Summary Compensation Table will be reversed during the period in which it is no longer considered probable.

Forfeited awards and/or the reversal of previously reported performance-based awards would offset the compensation cost of awards and, in some cases, could result in negative stock-based compensation in the Summary Compensation Table, potentially impacting total compensation and the determination of the named executive officers.

Treatment of Non-Cash Compensation in Lieu of Salary or Bonus

The new rules also revise the instructions to the Summary Compensation Table Salary and Bonus columns regarding salary or bonus forgone at the election of a named executive officer in favor of receiving a non-cash form of compensation such as a stock or option award. Under the old rules, this amount was permitted to be excluded from the Salary or Bonus column as long as the related non-cash award was reported in the Stock Awards or Option Awards column in the Summary Compensation Table. The new rules now require the forgone amount to be reported in the Salary or Bonus column, with footnote disclosure of the receipt of non-cash compensation that refers to the Grants of Plan-Based Awards Table where the stock, option or non-equity incentive plan award is reported.

Note that the new rules do not expressly provide that the non-cash award received in lieu of forgone salary or bonus should be excluded from the applicable Stock Awards or Option Awards column, although the text of the release so implies. The rules themselves simply require the Stock Awards and Option Awards columns to reflect the FAS 123R compensation expense in respect of these awards for the subject year. This normally would include expenses associated with stock or option awards received in lieu of forgone salary or bonus. However, the SEC staff has confirmed to us that this was not the intent of the amendments and that any stock or option awards received in lieu of forgone salary or bonus included in the Salary or Bonus columns should not also be reflected in the Stock Awards or Option Awards columns.

Grants of Plan-Based Awards Table

The new rules require disclosure, on a grant-by-grant basis, of the full grant date fair value of each equity award in a new column to the Grants of Plan-Based Awards Table. Thus, while the full grant date value of an equity award will no longer be included in the calculation of total compensation in the Summary Compensation Table, these amounts will still be required to be disclosed in the Grants of Plan-Based Awards Table in the year of grant. The new rules also amend the Grants of Plan-Based Awards Table to include information concerning repriced or materially modified options, stock appreciation rights and similar option-like instruments. Issuers must disclose the incremental fair value on a grant-by-grant basis, computed as of the repricing or modification date in accordance with FAS 123R.

Director Compensation Table

The new rules revise the Director Compensation Table in the same manner as the changes described above for the Summary Compensation Table. The new rules require the dollar amount of compensation associated with director stock and option awards disclosed in the Director Compensation Table with respect to a fiscal year to reflect the amount recognized as compensation cost in respect of these types of awards in the company's financial statements for that year in accordance with FAS 123R, whether or not the awards were granted in that year.

In addition, the new rules amend the Director Compensation Table to require footnote disclosure of the grant date fair value of each equity award and the incremental fair value, on a grant-by-grant basis, of repriced or materially modified options, stock appreciation rights and similar option-like instruments, computed as of the repricing or modification date in accordance with FAS 123R.

The new rules also require that any fees forgone at the election of the director in favor of receiving stock or other equity-based or non-cash compensation must be reported in the Fees Earned or Paid in Cash column of the Director Compensation Table, with footnote disclosure of the receipt of any such form of non-cash compensation.

The new rules were issued as interim final rules and although they are effective, the SEC is soliciting comments on the new rules until January 28, 2007. Information on submitting comments to the SEC can be found on the SEC's website at www.sec.gov/rules/submitcomments.htm.

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For Additional Information

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