PROSKAUER ROSE LLP®

Client Alert

A report for clients and friends of the firm

August 2006

Executive Compensation and Related Party Disclosure

On August 11, 2006, the Securities and Exchange Commission (the SEC) adopted amendments to the disclosure requirements for executive and director compensation, related party transactions, director independence, other corporate governance matters, and security ownership of officers and directors.[1] The new rules, as finally adopted, are substantially similar to the rules as originally proposed, although the SEC increased the disclosure obligations with respect to option grant practices in response to the recent option back dating controversy and did not adopt the controversial so-called "Katie Couric" provision, a revised version of which will be reproposed for public comment. The new rules will take effect for filings made on or after December 15, 2006 for fiscal years ending on or after December 15, 2006, which means that companies must comply with the new rules for the 2007 Form 10-K and proxy season. Changes to Form 8-K will take effect 60 days after publication of the new rules in the Federal Register. Compliance dates are discussed more fully at the end of this Client Alert.

Executive and Director Compensation Disclosure

Option Disclosure

The new rules require more disclosure about option grant practices than was originally proposed.[2] The new rules require the following tabular disclosure:

- the fair value of stock option grants in the Summary Compensation Table at the date of grant, as determined under FAS 123R;
- the grant date as determined under FAS 123R in a Grants of Plan-Based Awards Table;
- a separate, adjoining column in the Grants of Plan-Based Awards Table, showing the market price on the date of the grant, if the exercise price is less than the closing market price of the underlying security on the date of the grant; and
- a separate, adjoining column in the Grants of Plan-Based Awards Table, showing the date the compensation committee or board of directors took action to grant the option, if the actual grant date is different from the date the compensation committee or board of directors took action to make the grant.

Further, a description of the method used to determine the exercise or base price is required if it is not the same as the closing market price per share on the grant date.

In addition, a new Compensation Discussion and Analysis section, discussed further below, will require narrative disclosure regarding option grant timing and pricing. Companies should pay particular attention to the following points:

- Does a company have any program, plan or practice to time option grants to its executives in coordination with the release of material non-public information (whether positive or negative)?
- How does a company's option timing for executives fit with option grants to general employees?

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[1] The adopting release, Release No. 33-8732, is available at http://www.sec.gov/rules/final/2006/33-8732.pdf.

[2] The proposing release, Release No. 33-8655, dated January 27, 2006, is available at http://www.sec.gov/rules/proposed/33-8655.pdf.

- What was the role of the compensation committee in approving and administering option timing?
- What was the role of the executive officers in timing options?
- Does the company set the grant date of its stock option grants to new executives in coordination with the release of material non-public information?
- Does the company plan to time, or has it timed, its release of material non-public information for the purpose of affecting the value of executive compensation?
- Does the company have a program, plan or practice of awarding options and setting the exercise price on the stock's price on a date other than the actual grant date?
- If related to a material stock grant, does the company have provisions in its option plans or follow a practice of determining the exercise price by using formulas based on average prices (or lowest prices) of the company's stock in a period preceding, surrounding, or following the grant date?

Compensation Discussion and Analysis Section

The new rules require an overview of compensation policies called the Compensation Discussion and Analysis section (CD&A). The form of the CD&A is narrative. The CD&A discusses and analyzes the material factors underlying a company's policies and decisions about the compensation of the executive officers named in the Summary Compensation Table (the named executive officers) that is reflected in the compensation tables.[3]

The CD&A will be similar to Management's Discussion and Analysis of Financial Condition and Results of Operations (the MD&A). Boilerplate language should be avoided. As was proposed, the adopting release provided the following questions that a company should answer in its CD&A:

- What are the objectives of the company's compensation programs?
- What is the compensation program designed to reward?
- What is each element of compensation?
- Why does the company choose to pay each element?
- How does the company determine the amount (and the formula) for each element?
- How does each element, and the company's decisions about that element, fit into the company's overall compensation objectives, and affect decisions regarding other elements of compensation?

Excluded information. Companies will not be required to disclose target levels for specific quantitative or qualitative performance factors (unless they were disclosed previously), or any factors involving confidential commercial or business information whose disclosure would adversely affect the company. The standard for deciding whether there is an adverse affect would be the same standard applied in confidential treatment requests for trade secrets.[4]

Filed not furnished. The CD&A will constitute company disclosure filed, rather than furnished, with the SEC. If the CD&A is incorporated by reference into a periodic report (as is typically the case for Form 10-Ks incorporating proxy statement disclosure), the CD&A would be covered by the certifications of the principal executive officers and principal financial officers under the Sarbanes-Oxley Act of 2002.

Compensation Committee Report

In addition to the CD&A, the new rules require a Compensation Committee Report, which will be furnished rather than filed. The report will not be covered by the certifications of the principal executive officers and principal financial officers under the Sarbanes-Oxley Act of 2002. The report will be similar to the Audit Committee Report, except that the report will be required to be included or incorporated by reference into the company's annual report

[3] The adopting release also gives several examples of material factors a company might address in the CD&A, including: (i) its policies for allocating between long-term and currently paid compensation; (ii) its policies for allocating between cash and non-cash compensation, and among different forms of non-cash compensation; (iii) its basis for allocating among different forms of long-term compensation; (iv) how it decides when to grant awards, including equity awards such as options; (v) what items of corporate performance it considers when it makes compensation decisions and how elements of compensation are structured and implemented to reflect these items of the company's performance and the executive's individual performance; (vi) what impact tax and accounting treatments have on different forms of compensation; (vii) factors considered in decisions to increase or decrease compensation materially; (viii) how compensation or amounts realizable from prior compensation are considered in setting other elements of compensation; (ix) the company's equity or other security ownership requirements or guidelines and any company policies regarding hedging the economic risk of such ownership; (x) whether the company engaged in benchmarking of total compensation or any material element of compensation, identifying the benchmark and, if applicable, its components; (xi) the role of executive officers in the compensation process; (xii) company policies and decisions regarding the adjustment or recovery of awards or payments if the relevant company performance measures upon which they are based are restated or otherwise adjusted in a manner that would reduce the size of an award or payment; and (xiii) the basis for selecting particular events as triggering payment with respect to post-termination agreements.

[4] See Staff Legal Bulletin 1A on the SEC's website at www.sec.gov.

on Form 10-K so that it is presented along with the CD&A. The name of each member of the company's compensation committee (or the board of directors or persons performing equivalent functions) must appear below the report. The report must state:

- whether the compensation committee has reviewed and discussed the CD&A with management; and
- based on the review and discussions, whether the compensation committee recommended to the board of directors that the CD&A be included in the company's annual report on Form 10-K and, as applicable, the company's proxy or information statement.

Performance Graph

The proposed rules would have eliminated the performance graph. Under the new rules, the performance graph is still required, but not as compensation disclosure. Instead, it will be moved from the proxy statement and presented in the annual report to shareholders, which accompanies or precedes the proxy statement, along with other market data for the company's stock. The performance graph will continue to be furnished and not filed with the SEC.

Compensation Tables

Revised Summary Compensation Table

The revised Summary Compensation Table and related disclosure show compensation of each named executive officer for each of the three most recently completed fiscal years, whether or not the compensation was actually paid out during that period. We have attached a copy of the form of Summary Compensation Table as **Appendix A**.

Total compensation column. A company will be required to disclose total compensation for each named executive officer in a new "total" column, located at the far right of the Summary Compensation Table. A company will calculate total compensation for each named executive officer by adding up the total dollar value of each amount of compensation shown in the other columns located in the table.

Separate column for annual change in the pension value and nonqualified deferred compensation earnings. As adopted, the new rules require a separate column in the Summary Compensation Table reporting the annual change in the actuarial present value of accumulated pension benefits and above-market or preferential earnings (as opposed to <u>all</u> earnings, as originally proposed) on nonqualified deferred compensation in the "All Other Compensation" column. The above-market or preferential portion is determined for interest by reference to 120% of the applicable federal long-term rate, and for dividends by reference to the dividend rate on the company's common stock.

In a change from the rules as originally proposed, the annual change in the actuarial present value of accumulated pension benefits and above-market or preferential earnings on nonqualified deferred compensation will not be considered in determining which executive officers are included in the Summary Compensation Table.

Salary and bonus as of the most recent practicable date. If the amounts for the "salary" or "bonus" columns cannot be calculated as of "the most recent practicable date," a company must disclose this in a footnote and provide an estimate of the date when it will be determined. The company will then be required to file an Item 5.02 Form 8-K upon a payment, decision, or other event resulting from the amount of salary or bonus being determined.

Deferred compensation. If receipt of any amount of compensation is deferred for any reason, the compensation will still be disclosed in the appropriate column.

Stock awards. A new "stock awards" column (replacing the former "restricted stock award(s)" column) will show stock-related awards like restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalents or similar instruments without option-like features. Stock awards will be valued at grant date fair value determined under FAS 123R for financial reporting purposes.

Options. The "options awards" column will show awards of options, stock appreciation right grants and similar instruments with option-like features that are within the scope of FAS 123R. Instead of showing the number of securities underlying the awards (as the former rules required), a company will show the grant date fair value of the award determined under FAS 123R for financial reporting purposes. The compensation cost calculated as the grant date fair value will be shown as compensation in the year the grant was made. Transferred awards would be shown in the options column. Awards that were repriced in the last fiscal year will be shown at the incremental fair value computed as of the repricing or modification date in accordance with FAS 123R. Any earnings on awards, such as dividends, that are not included in the grant date fair value computation for those awards must be disclosed when the dividends or other earnings are paid.

Assumptions made in valuing stock and option awards. A company must provide footnote disclosure of the assumptions it made in valuing its stock awards or option awards, and reference its notes to financial statements or MD&A. Companies delivering proxies on the Internet could provide hyperlinks from the proxy to the sections referenced in the Form 10-K. The sections of the financial notes or MD&A referenced by the company will be deemed part of its executive compensation disclosure under Item 402 of Regulation S-K.

Non-Equity Incentive Plan Compensation. The "non-equity incentive plan compensation" column will show the dollar value of all awards earned under non-equity incentive plans during the fiscal year. This would cover awards under incentive plans that are not within the scope of FAS 123R. Awards will be considered "earned" in the year when the performance criteria are satisfied, whether or not payment was actually made to the named executive officer in that year. Earnings on awards, accrued or paid, will be shown in the column and described by type and amount in a footnote.

All Other Compensation. All compensation not properly reportable in the other columns must be reported in this column. The "Other Annual Compensation" column will be eliminated. Each item of compensation shown in this column that exceeds $10,000 will be described by type and amount in a footnote. The adopting release lists several items that a company should disclose in this column:

- perquisites and other personal benefits, unless they aggregate to less than $10,000 (discussed further below);
- "gross-ups" or other amounts reimbursed during the fiscal year for the payment of taxes;
- amounts paid or accrued pursuant to a plan or arrangement in connection with any termination (including constructive termination) or a change in control;
- annual company contributions or other allocations to vested and unvested defined contribution plans;
- the dollar value of any insurance premiums paid by the company with respect to life insurance for the benefit of a named executive officer; and
- the compensation cost, if any, computed under FAS 123R for any security of the company or its subsidiaries purchased from the company or its subsidiaries (through deferral of salary or bonus) at a discount from the market price of such security at the date of purchase, unless that discount is available generally either to all security holders or to all salaried employees of the company.

Perquisites. The new rules eliminate the former minimum reporting threshold of $50,000 or 10% of the total of annual salary and bonus. As was proposed, unless the aggregate value of perquisites and personal benefits is less than $10,000, the particular nature of any perquisite will be identified in footnote disclosure. For example, clothing, jewelry, artwork, theater tickets and housekeeping services should not be defined generally as "travel and entertainment." If the value of the perquisite or personal benefit is valued at the greater of $25,000 or 10% of total perquisites and other personal benefits, that value will be disclosed in a footnote.

As was proposed, the new rules retain the former standard for valuing perquisites or personal benefits based on the aggregate incremental cost to the company and its subsidiaries. The company's method for computing the aggregate incremental cost for perquisites must be disclosed in a footnote.

The original proposing release provided interpretive guidance about what company-provided items should be disclosed as perquisites or other personal benefits. We summarized that interpretive guidance for you in our Client Alert dated February 1, 2006.[5] The adopting release provides further interpretative guidance regarding what is a perquisite. The adopting release repeats the two-pronged test for determining whether a company-provided item is a perquisite:

- An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties.
- Otherwise, an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect, without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees.

The adopting release recommends that companies start with the first prong in applying the test for determining whether an item is a perquisite. An item that is "integrally and directly related to the performance of the executive's duties" is an item that the company provides to an executive because the executive needs it to do the job. If the executive needs the item to do his or her job, then the item is not a perquisite and no compensation disclosure is required.

Only if the executive does not need the item to do his or her job would the second prong come into play. In

[5] Our Client Alert dated February 1, 2006 is available on our website at http://www.proskauer.com/news_publications/client_alerts/content/2006_02_02/_res/id=sa_PDF/11508-020106-SEC%20Interpretive%20Guidance%20and%20Proposals.pdf

applying the second prong, a company would ask, "Does the item confer a direct or indirect benefit that has a personal aspect (without regard to whether it may be provided for some business reason or for the convenience of the company)?" If the answer is yes, the item is a perquisite and compensation disclosure is required, unless the item is generally available on a nondiscriminatory basis to all employees. A company may reasonably conclude that an item is generally available to all employees on a non-discriminatory basis if it is available to those employees to whom it lawfully may be provided. In contrast, merely providing a benefit consistent with its availability to employees in the same job category or at the same pay scale does not establish that it is generally available on a non-discriminatory basis to all employees.

Examples of items requiring disclosure as perquisites include, but are not limited to:

- club memberships not used exclusively for business entertainment purposes;
- 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 an executive or director to stay at his or her personal residence);
- security provided at a personal residence or during personal travel;
- commuting expenses (whether or not for the company's convenience or benefit); and
- discounts on the company's products or services not generally available to employees on a non-discriminatory basis.

Director compensation. For a named executive officer who is also a director, his or her compensation for director services will be reported in the appropriate column(s) of the Summary Compensation Table, rather than in the separate Director Compensation Table discussed below. Each type and amount of director compensation will be disclosed in footnotes.

Grant of Plan-Based Awards Table

The proposed rules would have required two tables that explain information in the Summary Compensation Table — the Grants of Performance-Based Awards Table and the Grants of All Other Equity Awards Table. Instead, the final rules combine the two proposed tables into a single table captioned "Grants of Plan-Based Awards." We have attached a copy of the form of this table as **Appendix B.**

Disclosure in this table complements disclosure in the Summary Compensation Table of grant date fair value of stock awards and option awards by disclosing the number of shares of stock or units comprising or underlying the award. The table also shows the terms of grants made during the current year, including estimated future payouts for both equity incentive plans and non-equity incentive plans, with separate disclosure for each grant.

If the per-share exercise or base price of options, stock appreciation rights and similar option-like instruments is less than the market price of the underlying security on the grant date, a separate column must be added showing market price on the grant date. The grant date market price is calculated using the closing price per share of the underlying security, which is the last sale price on the principal United States market for the security on the specified date.

If the exercise or base price is not the grant date closing market price per share, a description of the method for determining the exercise or base price is required either by footnote to the table or in the accompanying narrative section. If the date on which the compensation committee (or the board of directors or a committee of the board) took action or is deemed to have taken action to grant equity-based awards is different from the date of grant, a column must be added to disclose the date of action. The "date of grant" or "grant date" is the grant date determined for financial statement reporting purposes pursuant to FAS 123R. If a non-equity incentive plan award is denominated in units or other rights, then a separate, adjoining column would be required to disclose the units or other rights awarded.

Narrative Disclosure to Tables

Material factors. A company must provide a narrative describing any material factors necessary to an understanding of the information disclosed in the compensation tables. Material factors may include:

- material terms of named executive officer employment agreements;

- repricings (the new rules eliminate the ten-year option repricing table) or other material modifications of outstanding stock-based awards during the last fiscal year, including extensions of exercise periods, changes in vesting, forfeiture terms or non-confidential performance criteria; and

- terms such as formulas used to determine amounts payable, vesting schedules, performance-based conditions, dividends and applicable rates (excluding any factor or condition that involves confidential commercial or business information).

Compensation of non-executive officers; the "Katie Couric" provision. As proposed, the narrative accompanying the Summary Compensation Table would have required disclosure for up to three employees who were not executive officers during the last completed fiscal year, but whose total compensation was greater than that of any of the named executive officers. In the adopting release, this controversial provision will be revised and reproposed for public comment. The new proposal would require that the accompanying narrative disclosure include the total compensation (excluding the same items that would be deducted from total compensation for purposes of determining named executive officers) and job positions of each of the company's three most highly compensated employees, whether or not they were executive officers during the last completed fiscal year, whose compensation for the last completed fiscal year was greater than that of any of the named executive officers included in the tables, except that employees having no responsibility for significant policy decisions within the company, a significant subsidiary or a principal business unit, division or function would be excluded when determining which employees are among the most highly compensated. Under the revised proposal, this provision would only apply to large accelerated filers, who have greater than $700 million in market capitalization. We will issue a separate Client Alert when this proposal is finalized.

Exercises and Holdings of Previously Awarded Equity

The new rules provide for two tables showing equity compensation to named executive officers that has been previously awarded and that remains outstanding as of fiscal year-end.

Outstanding Equity Awards at Fiscal Year-End Table. A copy of the form of this table is attached as **Appendix C.** This table will cover outstanding equity awards, including those made under stock option plans, stock appreciation rights plans, restricted stock plans and incentive plans. The table will require disclosure of:

- the number of securities underlying unexercised instruments that are exercisable;

- the number of securities underlying unexercised instruments that are unexercisable;

- the exercise or base price; and

- the expiration date.

Options Exercises and Stock Vested Table. A copy of the form of this table is attached as **Appendix D.** This table would show the number of shares acquired by a named executive officer upon the exercise of options or vesting stock awards during the last fiscal year and the value of those shares as of the exercise or vesting date. The final rules adopt this table without a proposed column that would have reflected the grant date fair value.

Post-Employment Compensation

Pension Benefits Table. The new rules eliminate the former pension plan table. A proposed table would have disclosed estimated annual retirement payments under defined benefit plans for each named executive officer. Instead, the new rules adopt a modified table requiring disclosure of the actuarial present value of the named executive officer's accumulated benefit under the pension plan and the number of years of service credited to the named executive officer under the plan reported in the table, each computed as of the same pension plan measurement date for financial statement reporting purposes with respect to the audited financial statements for the company's last completed fiscal year. A copy of the form of this table is attached as **Appendix E.**

In addition, the new rules require a narrative description of the material factors necessary to an understanding of each plan shown in the table. Some examples include:

- material terms and conditions of benefits available under the plan, including the benefit formula, eligibility standards and early retirement arrangements;

- each element of compensation included in the benefit formula;

- reasons for participation in multiple plans; and

- company policy for granting extra years of credited services.

Nonqualified Deferred Compensation Table. A copy of the form of this table is attached as **Appendix F.** This table will disclose contributions, earnings and balances under each defined contribution plan or other plan that provides for the deferral of compensation on a basis that is not tax-qualified. The new rules require footnote explanation tying the contributions and earnings amount in this table to deferred compensation reported in the Summary Compensation Table for previous years. In addition, the new rules require narrative description of the material factors necessary to an understanding of each plan shown in the table. Examples include:

- types of compensation permitted to be deferred and any limitations on permitted deferrals;
- measures of calculating interest or other plan earnings, terms for selection of measures, and interest rates for the last fiscal year; and
- material terms of payouts, withdrawals and other distributions.

Other Potential Post-Employment Payments. The new rules require narrative disclosure of payments related to the resignation, severance, retirement or other termination of a named executive officer, a change in a named executive officer's responsibilities or a change in control in the company. A company must describe:

- specific circumstances that would trigger payment under the termination or change-in-control arrangements or the provision of other benefits (including perquisites and health care benefits);
- estimated payments and benefits that would be provided in each termination scenario, whether they would be lump-sum or annual, their duration, and the party responsible to make the payments;
- factors used to determine appropriate payment and benefit levels under various triggering scenarios;
- material conditions or obligations of receipt of payments or benefits, including non-compete, non-solicitation, non-disparagement or confidentiality covenants;
- duration of noncompetes;
- tax gross-up payments; and
- any other material features necessary for an understanding of the provisions.

In the event that uncertainties exist regarding payments or benefits, a company would provide reasonable estimates and disclose the material assumptions underlying the estimates. These estimates would fall within the safe harbor for forward-looking information. The quantitative disclosure required will be calculated applying the assumptions that:

- the triggering event took place on the last business day of the company's last completed fiscal year; and
- the price per share of the company's securities is the closing market price as of that date.

If a triggering event has occurred for a named executive officer who was not serving as a named executive officer at the end of the last completed fiscal year, disclosure under this provision is required for that named executive officer only with respect to the actual triggering event that occurred. Health care benefits are included in this requirement and quantified based on the assumptions used for financial reporting purposes under generally accepted accounting principles.

Officers covered

Named executive officers. The new rules specifically add the CFO (renamed the Principal Financial Officer) as a named executive officer. The named executive officers would be:

- the CEO (renamed the Principal Executive Officer);
- the Principal Financial Officer;
- the three most highly compensated executive officers other than the Principal Executive Officer and the Principal Financial Officer; and
- up to two additional individuals for whom disclosure would have been required but for the fact that they were no longer serving as executive officers at the end of the last completed fiscal year.

Like the Principal Executive Officer, if the Principal Financial Officer served in that capacity for any part of the fiscal year, information will be required as to all of his or her compensation for the full fiscal year.

Most highly compensated executive officers. The most highly compensated executive officers will be determined on the basis of total compensation for the last fiscal year, reduced by the sum of the increase in the pension values and nonqualified deferred compensation above-market or preferential earnings, all as reported in the Summary Compensation Table. The new rules eliminate the former carve-out for cash compensation not recurring and "unlikely to continue," but retain the former carve-out for cash compensation for overseas assignments.

Minimum reporting threshold. The new rules change the basis for calculating the $100,000 minimum reporting threshold from total annual salary and bonus for the last fiscal year to total compensation for the last fiscal year.

Interplay of Item 402 and Item 404 of Regulation S-K

The new rules eliminate the exclusion from executive compensation reportable under Item 402 for related party transactions disclosed under Item 404. The adopting release acknowledges that as a result, in some circumstances, a company may be required to disclose the same transaction in two places, both as executive compensation under Item 402 and as a related party transaction under Item 404.

Other Changes

The new rules eliminate the exclusion from executive compensation disclosure under Item 402 for nondiscriminatory relocation plans that are generally available to salaried employees.

Director Compensation

The new rules create a new Director Compensation Table. A copy of the form of this table is attached as **Appendix G.** The Director Compensation Table is similar to the Summary Compensation Table, except that it will only cover the most recently completed fiscal year. Instructions provided in the Summary Compensation Table apply to similar matters in the Director Compensation Table. Like the Summary Compensation Table, the Director Compensation Table requires pension and nonqualified deferred compensation plan disclosure in a separate column.

Items in the "All Other Compensation" column would include but not be limited to:

- perquisites and other personal benefits if they aggregate to $10,000 or more;
- tax reimbursements;
- the compensation cost, if any, computed under FAS 123R for any security of the company or its subsidiaries purchased from the company or its subsidiaries (through deferral of fees or otherwise) at a discount from the market price of such security at the date of purchase, unless that discount is available generally either to all security holders or to all salaried employees of the company;
- amounts paid or accrued to any director pursuant to a plan or arrangement in connection with the resignation, retirement or any other termination of such director or a change in control of the company;
- annual company contributions to vested and unvested defined contribution plans;
- consulting fees;
- legacy or charitable awards, disclosed at the annual cost of the company's commitment, with footnote disclosure of total dollar amount and other material terms of the program; and
- the dollar value of any life insurance premiums paid for the director's benefit.

The new rules will require footnotes to the Directors Compensation Table, disclosing for each director the aggregate number of stock awards and the aggregate number of option awards outstanding at fiscal year-end.

A company can group directors having identical amounts and elements of compensation in a single row. A company also can omit from the Director Compensation Table any compensation to a named executive officer that is disclosed in the Summary Compensation Table if it is identified in a footnote as compensation for director services.

In addition to the table, the rules require narrative description of the material factors necessary to an understanding of the table, including, for example, a breakdown of the types of director fees. Disclosure regarding option timing or dating practices may be necessary when the recipients of the stock option grants are directors of the company.

Small Business Issuers[6]

Small business issuers would not be required to provide a CD&A or the related Compensation Committee Report. Small business issuers would provide only the following tables (and accompanying narrative disclosure):

- the Summary Compensation Table, with information for only the last two fiscal years;
- the Outstanding Equity Awards at Fiscal Year-End Table; and
- the Director Compensation Table.

Small business issuers will only provide information for a total of three named executive officers, including the PEO and the two most highly compensated executive officers other than the PEO.

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[6] Under Item 10(a)(1) of Regulation S-B, small business issuers are U.S. or certain Canadian issuers that have less than $25 million in revenues and a public float of less than $25 million.

Foreign Private Issuers

A foreign private issuer will be deemed to comply with Item 402 of Regulation S-K if it provides the information required by Items 6.B and 6.E.2 of Form 20-F, with more detailed information provided if otherwise made publicly available or required to be disclosed by the issuer's home jurisdiction or a market in which its securities are listed or traded.

Business Development Companies and Investment Companies

The new rules will

- apply the executive compensation disclosure requirements for operating companies in their entirety to business development companies;
- increase to $120,000 the current $60,000 threshold for disclosure of certain interests, transactions and relationships of independent directors of registered investment companies, similar to the increase for operating companies with respect to related party disclosure; and
- reorganize the proxy rules applicable to investment companies to reflect organizational changes for operating companies.

Revisions to Form 8-K

The amendments to Form 8-K reorganize certain aspects of executive and director compensation disclosure.

Amended Item 1.01. The new rules eliminate employment compensation arrangements from Item 1.01. Employment compensation arrangements will now be covered under Item 5.02 of Form 8-K, as amended.

Amended Item 5.02. The new rules amend Item 5.02 to capture generally the information already required under that item, as well as additional information regarding material employment compensation arrangements involving named executive officers that had been called for under former Item 1.01. For purposes of this item, named executive officers are the persons for whom disclosure was required in the most recent filing with the SEC that required disclosure under Item 402(c) of Regulation S-K (or Item 402(b) of Regulation S-B for small business issuers).

Former Item 5.02(b) required disclosure of the retirement, resignation, termination, refusal to stand for re-election or removal of directors and "specified officers" (the Principal Executive Officer, Principal Financial Officer, president, principal accounting officer, principal operating officer and any person performing similar functions). The new rules expand Item 5.02(b) to also require this disclosure for named executive officers for the last fiscal year (whether or not they are "specified officers").

The new rules also expand Items 5.02(c) (triggered by an appointment of a new specified officer) and 5.02(d) (triggered by election of a new director except by shareholder vote) to require a brief description of any material plan, contract or arrangement (or material amendment) to which a specified officer or director is a party or participant that is entered into in connection with an Item 5.02 triggering event, or any grant or award (or modification) to any such person in connection with an Item 5.02 triggering event.

New Item 5.02(e). The new rules also create new Item 5.02(e), which requires that where a company enters into, adopts or commences a material compensatory plan, contract or arrangement (or material amendment) in which the Principal Executive Officer, Principal Financial Officer or any named executive officer for the most recent fiscal year is a party or participant, or a material grant or award (or material modification) is made, then the company will provide a brief description of the plan, contract or arrangement and the amounts payable to the officer. A company must provide Item 5.02(e) disclosure for a named executive officer regardless of whether the new plan, contract or arrangement (or amendment) is related to an Item 5.02 triggering event.

A company will not be required to disclose grants or awards (or modifications) under Item 5.02(e) that are materially consistent with the terms of previously disclosed plans, contracts or arrangements, if the grants or awards (or modifications) are disclosed the next time the company is required to provide new disclosure under Item 402 of Regulation S-K.

Item 5.02(e) disclosure will fall within the safe harbors from liability under Section 10(b) and Rule 10b-5 of the Exchange Act for failure to timely file Form 8-K reports and related Form S-3 ineligibility.

New Item 5.02(f)
Under new Item 5.02(f), a company must disclose salary and bonus for the most recent fiscal year that was not available at the most recent practicable date in connection with its disclosure under Item 402 of Regulation S-K.

Item 5.02 is not an updating of Item 402
The adopting release cautions that revised Item 5.02 only calls for a brief description of the specific information required, rather than an updating of the company's Item 402 disclosure.

General Instruction D
The new rules amend General Instruction D to Form 8-K to permit companies to omit the Item 1.01 heading in a Form 8-K that also discloses any other item, so long as the substantive disclosure required by Item 1.01 is included in the Form 8-K.

Foreign Private Issuers
The new rules amend the exhibit instructions to Form 20-F so that foreign private issuers will be required to file an employment or compensatory plan with management or directors (or portion of such plan) only when the foreign private issuer either is required to publicly file the plan (or portion of it) in its home country or if the foreign private issuer has otherwise publicly disclosed the plan.

Beneficial Ownership Disclosure

The new rules require footnote disclosure to the Security Ownership of Certain Beneficial Owners and Management Table disclosing the number of shares pledged as security by named executive officers, directors and director nominees. The new rules do not require this disclosure of significant shareholders (except to the extent disclosure is already required of pledges that may result in a change of control under Item 403(c) of Regulation S-K). Finally, the new rules require disclosure of beneficial ownership of directors' qualifying shares, which was not formerly required.

Certain Relationships and Related Transactions Disclosure

Transactions with Related Persons

Under amended Item 404(a) of Regulation S-K, a company must disclose:

- any transaction since the beginning of the company's last fiscal year or any currently proposed transaction
- in which the company was or is to be a participant,
- in which the amount involved exceeds $120,000 (increased from the former threshold of $60,000); and
- in which any related person had, or will have, a direct or indirect material interest.

Materiality standard. As was proposed, the new rules eliminate several of the former instructions to Item 404(a) about what types of transactions are material. But the standard for deciding whether a transaction is material under revised Item 404(a) will not change. The standard will remain the significance of the information to investors in light of all the circumstances, taking into account, without limitation, the importance of the interest to the person having the interest, the relationship of the parties to the transaction with each other and the amount involved in the transactions.

No bright lines. The new rules eliminate former Instruction 9 to Item 404(a), which had indicated that the $60,000 threshold was not a bright-line materiality standard. Like the proposing release, the adopting release cautions that, similarly, the new $120,000 threshold is not a bright-line test. However, when a transaction exceeds the threshold, a company should evaluate whether the related person has a direct or indirect material interest in the transaction to determine if disclosure is required.

New Definitions

Amended Item 404(a) defines "transactions," "related person" and "amount involved" in order to streamline Item 404(a) and to clarify the broad scope of financial transactions and relationships covered by the rule.

"Transaction" includes a series of similar transactions, and specifically includes indebtedness and guarantees of indebtedness.

"Related person" now includes stepchildren, stepparents and persons sharing a household (except tenants and employees). A "related person" means any person who had any of the following relationships at any time during the last fiscal year:

- director or executive officer (or director nominee for disclosure in a proxy for the election of directors);
- any immediate family member of a director, executive officer or nominee, meaning any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and any person (other than a tenant or employee) sharing the household of a director, officer or nominee; and
- any significant shareholder or any of its immediate family members (unless the person was not a significant shareholder, or its immediate family member, at the time of the transaction).

"Amount involved" means the dollar value of the transaction, including:

- for leases or other transactions with periodic payments, the aggregate amount of all periodic payments due during the last fiscal year; and

- for indebtedness, the largest aggregate principal amount of all indebtedness outstanding during the last fiscal year, and all interest payable on it during the last fiscal year.

Indebtedness

Under the proposed rules, companies would have been required to disclose material direct and indirect interests in indebtedness with significant shareholders or their immediate family members. That proposal, however, was not adopted. The new rules do not require disclosure of indebtedness transactions of significant shareholders or their immediate family members.

As was proposed, the new rules fold former requirements to disclose indebtedness under Item 404(c) into amended Item 404(a). This integration will set a $120,000 threshold and require disclosure if there is a direct or indirect material interest in an indebtedness transaction. (In contrast, former Item 404(c) required disclosure of all indebtedness exceeding $60,000.) As a result, disclosure requirements for indebtedness and for other related party transactions will be congruent. Loans by companies other than financial institutions will be treated like any other related party transaction.[7]

Disclosure Requirements

What is required. A company must disclose:

- the related person's relationship to the company;
- the related person's interest in the transaction with the company (including his or her ownership in any entity that is a party to the transaction);
- the approximate dollar value of the amount involved in the transaction and of the related person's interest in the transaction (without regard to profit or loss involved in the transaction); and
- any other information about the transaction or the related person that is material to investors in light of the circumstances.

What is not required. Named executive officer and director compensation will not be required under Item 404 if the compensation was reported under Item 402. Executive officer compensation will not be required under Item 404 if (i) the compensation would have been reportable under Item 402 if the officer was a named executive officer, (ii) the officer is not an immediate family member of another related person, and (iii) the compensation committee approved the compensation.

In addition, a company will not be required to disclose:

- certain ordinary business debt or indebtedness with institutional lenders that was made in the ordinary course of business;
- any transaction where the rates or charges involved in the transaction are determined by competitive bids;
- transactions involving services as a bank depositary of funds, transfer agent, registrar, trustee under a trust indenture or similar services; and
- if the interest of the related person arises solely from the ownership of a class of equity securities of the company and all holders of that class of equity securities of the company received the same benefit on a pro rata basis

Finally, directors and less than ten percent equity owners or limited partners of participants in a transaction with the company will not be deemed to have an "indirect material interest" in a transaction.

Procedures for Approval of Related Party Transactions

A company must describe its policies and procedures for review and approval of related party transactions that will be reportable under Item 404(a), including their material features.

Some examples are:

- the board members responsible for applying the policies and procedures;
- the standards to be applied; and
- whether the policies and procedures are written.

In addition, a company will identify any situations where its policies and procedures did not require review or approval of a transaction that was reportable under Item 404(a), or where its policies and procedures were not followed for such a transaction.

Promoters

New Item 404(c) would require companies to disclose in certain registration statements transactions with promoters if

[7] Section 402 of the Sarbanes-Oxley Act of 2002 prohibits most personal loans by a company to its officers and directors. See Section 13(k) of the Exchange Act.

a company had a promoter at any time during the past five fiscal years, regardless of when the company was organized.

Corporate Governance

The new rules create Item 407 of Regulation S-K, which will consolidate and update former disclosure requirements for director independence and related corporate governance matters.

Independent directors and non-independent committee members. A company must disclose those directors and nominees that it identifies as independent, and those board committee members that it does not identify as independent. If the company is a listed issuer on a national securities exchange, the company must apply definitions for director and committee member independence that comply with the listing standards applicable to the company. If the company is not a listed issuer, the company must apply definitions for director independence of a national securities exchange chosen by the company. Companies must apply the same definition from the same national securities exchange uniformly to all directors and committee members.

A company that adopted and applied its own definitions of independence for directors and committee members is required to disclose whether the definitions are posted on the company's website. If the definitions were not posted on the company's website, the company will be required to attach a copy of the definitions to its proxy at least once every three years.

Relationships considered in determining independence. For each director or nominee identified as independent, a company is required to describe, by specific category or type, any transaction, relationship or arrangement not disclosed under amended Item 404(a) that was considered by the board in determining the director's or nominee's independence.

Item 407 disclosure is required for any person who served as a director during any part of the last fiscal year, even if his or her term ended.

Audit committee charter. A company will no longer be required to deliver its audit committee charter to its shareholders if the charter is posted on the company's website.

New compensation committee disclosure. A company must disclose the following information about its compensation committee:

- the scope of its authority (or of persons performing equivalent functions);
- the extent to which it may delegate authority;
- whether it has a charter, and if so, the company's website address where a current copy is available;
- any role of executive officers in determining the amount or form of executive and director compensation; and
- the identity of any compensation consultants as well as detailed information regarding their role in determining or recommending the amount or form of executive and director compensation.

The new rules consolidate in Item 407 information with respect to compensation committee interlocks and insider participation in compensation decisions formerly required under Item 402(j) of Regulation S-K.

Plain English

Companies must present their disclosure of executive and director compensation, related party transactions, beneficial ownership, and corporate governance in Exchange Act reports using the "plain English" standards adopted by the SEC in 1998. If a disclosure is incorporated by reference into an Exchange Act report from a company's proxy statement, the disclosure in the proxy statement will have to be written in plain English.

The adopting release lists some plain English do's, including:

- present information in clear, concise sections, paragraphs and sentences;
- use short sentences, everyday words and the active voice;
- use descriptive headings and subheadings; and
- use charts or bullet lists for complex material.

The adopting release also lists some plain English don'ts, including:

- vague boilerplate explanations;
- multiple negatives;
- legal, technical or business jargon;
- repeating disclosure in different sections without enhancing the quality of the information;
- complex information copied directly from legal documents; and
- overreliance on glossaries or defined terms.

Compliance Dates

The compliance dates for the new rules are as follows:

- for Forms 10-K and 10-KSB, compliance is required for fiscal years ending on or after December 15, 2006;

- for Forms 8-K, compliance is required for triggering events that occur 60 days or more after publication of the new rules in the Federal Register;

- for proxy and information statements covering registrants other than registered investment companies, compliance is required for any proxy or information statement filed on or after December 15, 2006 that is required to include Item 402 and 404 disclosure for fiscal years ending on or after December 15, 2006;

- for proxy and information statements covering registered investment companies, compliance is required for any new proxy or information statement filed on or after December 15, 2006;

- for Securities Act registration statements covering registrants other than registered investment companies and Exchange Act registration statements (including pre-effective and post-effective amendments, as applicable), compliance is required for registration statements that are filed with the SEC on or after December 15, 2006 that are required to include Item 402 and 404 disclosure for fiscal years ending on or after December 15, 2006; and

- for initial registration statements and post-effective amendments that are annual updates to effective registration statements that are filed on Forms N-1A, N-2 and N-3 (except those filed by business development companies), compliance is required for registration statements and post-effective amendments that are filed with the SEC on or after December 15, 2006.

Appendix A

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)	All Other Compensation ($)	Total ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO	________ ________ ________								
PFO	________ ________ ________								
A	________ ________ ________								
B	________ ________ ________								
C	________ ________ ________								

Appendix B

GRANTS OF PLAN-BASED AWARDS

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of Stock or Units (#)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option Awards ($/Sh)
		Thresh-hold ($)	Target ($)	Maxi-mum ($)	Thresh-hold (#)	Target (#)	Maxi-mum (#)			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
PEO										
PFO										
A										
B										
C										

Appendix C

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Option Awards					Stock Awards			
Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (#)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
PEO									
PFO									
A									
B									
C									

Appendix D

OPTION EXERCISES AND STOCK VESTED

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
(a)	(b)	(c)	(d)	(e)
PEO				
PFO				
A				
B				
C				

Appendix E

PENSION BENEFITS

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments During Last Fiscal Year ($)
(a)	(b)	(c)	(d)	(e)
PEO				
PFO				
A				
B				
C				

Appendix F

NONQUALIFIED DEFERRED COMPENSATION

Name	Executive Contributions in Last FY ($)	Registrant Contributions in Last FY ($)	Aggregate Earnings in Last FY ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last FYE ($)
(a)	(b)	(c)	(d)	(e)	(f)
PEO					
PFO					
A					
B					
C					

Appendix G

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash ($)	Stock Awards ($)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation ($)	Total ($)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
A							
B							
C							
D							
E							

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