



SEC Amends Proxy Disclosure Rules for Stock Awards

January 2007

In late December the SEC amended the executive compensation disclosure rules adopted last summer to change the manner of reporting stock option and other stock compensation. The changes affect the Summary Compensation Table (SCT), including the computation of "Total Compensation," Director Compensation Table (DCT), and Grants of Plan-Based Awards Table (Grant Table). The amendments are effective immediately upon publication in the Federal Register and will apply for the 2007 proxy season. However the SEC is also soliciting comments on these amendments, so additional changes may be adopted in the future.

Under the amendments, awards of stock and options are to be reported in the SCT and DCT using their value amortized over the service period for the award. This brings the value reported as compensation closer to the amount of expense recognized for financial statement reporting purposes under FAS 123R. As a result of this change, only the portion of the award attributable to service during the fiscal year (rather than the full grant date fair value of the award) will be disclosed in these compensation tables.

One key remaining difference between the FAS 123R expense and the proxy disclosure is the treatment of estimated forfeitures. The FAS 123R expense reflects an estimate of the number of awards that will be forfeited for failure to satisfy vesting conditions; this estimate is initially made at the time of grant and revised to reflect actual experience. By contrast, amounts shown in the proxy statement tables for service-vested awards must assume that the grant recipients named in the table will complete the service necessary to vest in the award. Any forfeitures during the year due to failure to satisfy the service conditions must be described in footnotes to the table, and can be used to reduce the compensation shown in the table for the year in which the award is forfeited. In the case of performance-vested awards, the SCT and DCT will include the award only if it is probable that the performance condition will be achieved, and the compensation will be reversed in a subsequent year if it is determined that vesting is no longer probable.

In a related change, a new column has been added to the Grant Table to show the full grant date fair value (on a grant-by-grant basis) for each stock or option award granted to the named executive officers during the fiscal year. Similar information is required to be provided in a footnote to the DCT. In addition, if an option is repriced or modified, the incremental fair value of the modified award must be shown.

Finally, under the amendment, the amount of any salary or bonus that an executive chose to forego in favor of an award disclosed in the Grant Table can no longer be excluded from the salary and bonus column of the SCT. The full amount must be shown in the SCT, with a footnote pointing to disclosure of the grant in the Grant Table.

Ramifications of the new provisions include the following:

- The amendment will likely affect the "Total Compensation" reported for an executive and may impact the determination of the company's named executive officers (NEOs). Before the amendment, the amount of the full grant date fair value of equity awards vesting over multiple years would have been included in Total Compensation in the year of grant. Since status as an NEO depends on Total Compensation, such inclusion would have increased the

variation of NEOs from year to year and complicated comparisons of year-to-year Total Compensation. Since the amendment now only requires reporting of the portion of the award attributable to service during the fiscal year, such variation likely will be reduced.

- If options vest on retirement, a grant to a retirement-eligible executive will be disclosed at its full value while grants to other executives will be disclosed over the service period.
- The amount shown in the SCT and DCT for “liability” awards (such as awards denominated in shares but payable in cash) will now reflect their “mark-to-market” accounting treatment. Depending on the movement of the company’s stock price this change could either increase or decrease the amount reported for a “liability” award as compared with the prior rule (where reporting was based on the full value at the date of grant).
- Under the transition rule chosen by the SEC, awards granted in prior years that vest in 2006 or later must now be included in the SCT (and DCT) as they vest.
- The amendment is likely to reduce concerns about whether to report an equity award made in the First Quarter as compensation for the year in which it was made or the prior year. This decision is now likely to be driven by the accounting treatment of the award.

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