

Frederic W. Cook & Co., Inc.

New York • Chicago • Los Angeles • San Francisco

December 28, 2006

**HEADS-UP ON EXECUTIVE COMPENSATION DISCLOSURE**

**SEC Amends Rules on Proxy Disclosure  
of Equity Awards Effective for 2007 Proxy Season**

On December 22<sup>nd</sup> the SEC unexpectedly adopted rules that amend the recently adopted rules for proxy disclosure of executive compensation. The new rules require inclusion of equity awards in the Summary Compensation Table (SCT) based on the FAS 123R compensation cost for the fiscal year rather than the full grant date fair value. The rules are effective immediately.

The new rules make significant revisions to the final rules<sup>1</sup> issued by the SEC on August 11<sup>th</sup> and apply to proxy statements filed on or after December 15, 2006 for fiscal years ending after that date. There will be a 30-day comment period after publication of the new rules in the Federal Register and the SEC will make revisions, if necessary, after considering comments.

**EQUITY AWARDS COLUMNS OF SUMMARY COMPENSATION TABLE**

The final rules approved on July 26<sup>th</sup> required the full grant date fair value of equity awards under FAS 123R to be included in the SCT stock and option awards columns. The amendments made by these new rules require disclosure of the compensation cost recognized for financial statement purposes for the fiscal year under FAS 123R (i.e., grant date fair value amortized over the requisite service period), disregarding estimated forfeitures related to service-based vesting conditions. The amount disclosed will be equal to the fiscal year compensation cost for awards granted in the current and prior fiscal years for a Named Executive Officer (NEO), including awards granted prior to the fiscal year for which disclosure is required; the new rules require use of the FAS 123R modified prospective transition method regardless of whether that method has been adopted for financial reporting purposes.

---

<sup>1</sup> Refer to our letter date August 14, 2006 that is available on our website at [http://www.fwcook.com/alert\\_letters/8-14-06\\_Heads-up\\_On\\_Executive\\_Compensation\\_Disclosure.pdf](http://www.fwcook.com/alert_letters/8-14-06_Heads-up_On_Executive_Compensation_Disclosure.pdf)

Example: Assume a calendar year company has the following grant history to its CEO:

<u>Date of Grant</u>	<u>Fair Value of Option Grant</u>	<u>Vesting Period</u>
1/1/04	\$400,000	4 years
1/1/05	600,000	4 years
1/1/06	900,000	3 years

Prior to these new rules, the SCT in the 2007 proxy statement would have included just the full fair value of \$900,000 for the 2006 grant. A similar amount would be in the Grants of Plan-Based Awards table.

Under the new rules, the SCT will reflect a value of \$550,000 (25% of '04 grant, 25% of '05 grant and 33% of '06 grant) while the Grants of Plan-Based Awards table will continue to show \$900,000.

Additional guidance provided by the SEC of using the amount recognized for the fiscal year's financial statements includes:

- If an equity award vests at retirement, the full FAS 123R grant date fair value will be included in the SCT for a stock or option award granted to an NEO who is eligible to retire (in addition, any remaining FAS 123R compensation cost of previously granted awards must be included in the first year an NEO becomes eligible to retire)
- The compensation cost of equity awards subject to a performance-based vesting condition will be included in the SCT when it is probable that the performance condition will be achieved and at the expected earn-out level (the cost will be reversed in a subsequent fiscal year if it is determined that achievement of the performance condition is no longer probable)
- If an equity award is forfeited because the requisite service period is not completed by an NEO, any compensation cost previously included in the SCT will be deducted for the fiscal year in which the award is forfeited and footnote disclosure describing the forfeiture will be required

Similar requirements apply to the inclusion of the value of stock and option awards in the Director Compensation table.

### **GRANTS OF PLAN-BASED AWARDS TABLE**

Under the new rules, the full FAS 123R grant date fair value of stock and option awards made during the fiscal year is reported in a new column in the Grants of Plan-Based Awards table on a grant-by-grant basis. Footnote disclosure to the Director Compensation table is required to include the full grant date fair value of each award of stock and options made in the fiscal year.

In addition, the new rules provide that the incremental FAS 123R fair value of repricings and modifications to options will be reported in this table rather than in the SCT.

### **ELECTIONS TO RECEIVE AWARDS IN LIEU OF SALARY AND BONUS**

The new rules require inclusion in the salary or bonus column of the SCT of any amount that an NEO elects to forego in exchange for an award of stock, options or non-equity incentive plan compensation. Footnote disclosure to the SCT salary or bonus column of the receipt of the award is required, including a reference to the Grants of Plan-Based Awards table where the award elected by the NEO is reported. Similar requirements apply to elections by directors relating to the fees column of the Director Compensation table.

\*\*\*\*\*

This letter is intended to alert compensation professionals about developments that may affect their companies, and should not be considered or relied upon as legal advice. Specific questions about the applicability of the amended SEC rules to proxy disclosure of compensation of executives and directors should be discussed with appropriate counsel. General questions applicable to the amended rules may be directed to Richard Alpern in our New York offices at 212-299-3599 or by email at [ralpern@fwcook.com](mailto:ralpern@fwcook.com). This letter and other published materials are available on our website, [www.fwcook.com](http://www.fwcook.com).