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Proposed SEC Disclosure Rules for Equity Compensation Plans[1]

In its continuing effort to provide full and fair disclosure to the investing public, the Securities and Exchange Commission has recently published for comment proposed amendments to the disclosure requirements applicable to proxy statements and periodic reports under the Securities Exchange Act of 1934. The purpose of these amendments is to enhance disclosure of the number of securities authorized for issuance and received by or allocated to participants under stock option and other employee equity compensation plans.

Present Situation

The use of equity compensation has dramatically increased during the last decade due to both larger individual grants and increased breadth of grants throughout employee ranks. This surge in equity compensation has sparked concern among institutional investors and shareholders over

- the lack of information and disclosure required by companies about existing and proposed compensation plans,
- the potential dilutive effect that compensation plans have on shareholders, and
- the ability of companies to adopt stock compensation plans without shareholder approval.

Currently, companies are under no duty to disclose the total number of securities they have authorized for their equity compensation programs on an ongoing basis.[2] Only when new plans are proposed or modified must this total be reported. Companies sometimes voluntarily disclose the remaining number of shares that are available for future grant under existing plans in the text or tables of an annual report footnote. Often, this number can be difficult to find since it is not

[1] SEC Release Nos. 33-7944, 34-43892; File No. S7-04-01
[2] Unless it is considered "material" in which case it should presumably be disclosed under GAAP.

required to be in a designated location or format. In addition, the disclosure may or may not include stock option awards granted to non-employees.

Revised disclosure by companies would enable investors and shareholders to ascertain more readily the total number of shares allocated to equity compensation plans. With this knowledge, investors would be able to make more informed decisions regarding the approval of new compensation plans or modification of existing plans.

Additionally, the issue of whether stock option plans should require shareholder approval has been an ongoing debate between companies, institutional investors and concerned individual shareholders. Currently, companies are able to avoid shareholder approval if the stock option plan is "broadly based" or if the company uses treasury shares to satisfy option exercises. Current disclosure rules make it difficult to determine whether a company has adopted a stock option plan without shareholder approval. Full and fair disclosure of whether a company's plans have been approved by shareholders would allow investors to more thoroughly understand the plans and policies that companies have in place.

Proposed Changes

The SEC is proposing that companies disclose, at least annually, summary information about the total number of securities that have been authorized for issuance, granted and those that remain available for grant under equity compensation plans in effect as of the end of the last completed fiscal year, whether or not approved by shareholders. The disclosure would follow the format below:

Equity Compensation Plan Information

(a)	(b)	(c)	(d)	(e)
Name of plan	**Number of securities authorized for issuance under the plan**	**Number of securities awarded plus number of securities to be issued upon exercise of options, warrants or rights granted during last fiscal year**	**Number of securities to be issued upon exercise of outstanding options, warrants or rights**	**Number of securities remaining available for future issuance**
Plan #1				
Plan #2				
Plan #3				
Individual Arrangements (Aggregated)				
Total				

The table and plan descriptions would be required to be placed in the proxy statement during years when shareholders would be voting on an equity compensation plan.[3] In all other years, the company would be required to disclose the table in its annual report on Form 10-K.

Individual arrangements could be aggregated together except that any individual arrangement exceeding 25% of the aggregate number of securities disclosed must identify the relationship of the recipient to the company and describe briefly, in narrative form, the material features of the arrangement. Moreover, any plan adopted without shareholder approval during the most recently completed fiscal year must be identified and described briefly, in narrative form, outlining the material features of the plan. If such plan was adopted in a prior fiscal year, the company must identify the filing containing the description of the plan.

Finally, these provisions would shed further light on the amount of repurchased or treasury shares that companies are using for compensation purposes under non-shareholder approved plans. Currently, treasury shares can be used for equity compensation purposes without the need for the company to obtain shareholder approval if the company is listed on the NYSE. These new provisions would not prevent a company from continuing to issue grants to executives through treasury shares, but they would provide some type of disclosure that could be monitored by shareholders.[4]

Implications

If these rules are adopted, investors will have consistent annual access to information that will aid them in making intelligent investment decisions. The value added to investors will come at the expense of additional compliance costs to companies. We believe that the benefits of such an exhibit greatly outweigh the relatively minor burden placed on companies.

However, the SEC did express concern that small companies may be affected more negatively by these new provisions than more established companies for the following reasons:

- Added disclosure may place pressure on companies to scale back on equity grants if the companies' existing policies are not viewed favorably by investors

- Small companies would find it increasingly difficult to attract and retain executives since they typically have limited cash reserves and rely more heavily on equity grants

For these reasons, the SEC is contemplating several alternatives, including an exemption from compliance for small entities.

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[3] This would include years in which an equity compensation plan is to be amended, such as to increase the number of securities authorized for issuance under the plan, or a new plan is to be adopted.
[4] Presently, the NYSE and NASDAQ are addressing the issue of whether there should be a cap on the use of shares under non-shareholder approved plans.

Our View

We are supportive of the move toward better disclosure. However, we believe that the SEC's proposal should be modified slightly. Presently, the SEC proposes that the Equity Compensation Table not be disclosed in the annual report during years when shareholders are to vote on a plan.

In order to provide consistency and clarity, we feel that the table should be disclosed every year in the annual report and additionally in the proxy statement in years when shareholders are being asked to vote on new or amended plans. Investors should not have to switch between the annual report and the proxy statement based on whether an equity plan is new or being modified.

Having the table in one place, the annual report footnotes, will provide one location that investors can rely on without fail to find the information. By incorporating our modification, the SEC would avoid any possible investor confusion as to location of the table.

Further Information

Copies of the SEC's proposal as well as contact information for submitting comments to the SEC, which are due on or before April 2nd, can be obtained from the SEC website at http://www.sec.gov

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Questions about this letter can be addressed to Louis C. Taormina in our New York office at 212-986-6330 or by e-mail at lctaormina@fwcook.com. Copies of this letter and published materials are available on our website at www.fwcook.com.