WT&P Alert: A periodic update for clients and friends of the Firm *January 2007*

SEC AMENDS EXECUTIVE COMPENSATION DISCLOSURE RULES FOR STOCK-BASED AWARDS

On December 22, 2006, the Securities and Exchange Commission announced that it had amended its new executive compensation and director disclosure rules to require disclosure in the Summary Compensation Table ("SCT") of the compensation cost of equity awards over the requisite service period as required under generally accepted accounting principles.[1] These amendments are effective generally for filings that relate to Regulation S-K Item 402 and Item 404 disclosures for fiscal years ending on or after December 15, 2006.

Under the final executive compensation disclosure rules adopted by the Commission on July 26, 2006 ("Final Rules")[2], the disclosure of the dollar value of equity awards in the SCT was based on the full grant-date fair value of the awards in accordance with FASB 123R. Many commentators were critical of this valuation approach and argued that disclosing the full grant date fair value in the SCT would overstate the total compensation received by named executive officers for the year, cause year-to-year swings in reported compensation even though the executive is earning a consistent level of compensation, and cause inconsistencies in the composition of the named executive officer group from year to year. As discussed below, the Commission retained disclosure of the full grant date fair value of awards by adding a new column to the "Grants of Plan-Based Awards" table.

Summary Compensation and Director Compensation Tables

The new interim final rules ("Interim Rules")[3] affect the amounts presented for stock and option grants in the SCT and the Director Compensation Table. Instead of presenting the aggregate grant-date fair value of awards in the tables computed in accordance with FASB 123R without regard to the effect of service or vesting requirements, which had been required under the Final Rules, companies will now present the portion of the fair value of the awards that represents earned compensation for the year as reflected in the financial statements.

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[1] FASB Statement 123 (revised 2004), Share-Based Payment, December 2004, available at www.fasb.org. FASB 123R defines a requisite service period as the period or periods over which an employee is required to provide service in exchange for a share-based payment. Under FASB 123R, although compensation cost is initially measured based on the award's grant date fair value, it is generally recognized for financial reporting purposes over the requisite service period.

[2] See Executive Compensation and Related Person Disclosure, Release No. 33-8732A (August 29, 2006 ("Final Rules"), which can be found at www.sec.gov/rules/final/2006/33-8732a.pdg. Our client alert regarding the Final Rules can be found in the "Articles" section of our website at www.wtplaw.com.

[3] The Interim Rules can be found at www.sec.gov/rules/final/2006/33-8765fr.pdf.

The amendments also revise the Director Compensation Table to (i) include footnote information regarding any repriced or materially modified options, SARs or similar option-like instruments (including disclosure of the incremental fair value of the award), and (ii) require footnote disclosure of the grant date fair value of each equity award, as computed in accordance with FAS 123R.

These amendments are intended to provide investors with a better view of the compensation earned by named executive officers and directors during a particular reporting period (*i.e.*, the requisite service or vesting period), and thus harmonize the disclosure required in the SCT with that required in the financial statements.

Grant of Plan-Based Awards Table

The full grant-date fair value[4] of each award to a named executive officer will be presented in a new column in the Grants of Plan-Based Awards Table. If options, SARs or similar option like instruments are repriced or materially modified, the incremental increase in the fair value of each award, as calculated in accordance with SFAS 123R, must be included in the Grant of Plan-Based Awards Table.

Forfeitures of Awards

Under the Interim Rule, the compensation cost disclosed in compliance with Item 402 will not include an estimate of forfeitures related to service-based vesting conditions for executive officers. The disclosure will assume that each officer will perform the requisite service to vest in the awards. If the award is forfeited, amounts previously included in the SCT will be deducted in the period forfeited, with the forfeitures described in a note to the table. Similar adjustments will be required for performance-based vesting conditions, if, for instance, achievement of the performance goal was probable at the grant date, but ceases to be probable at a later date or vice versa. These adjustments could, in some cases, result in a negative figure for the column, which would, in turn, affect the named executive officer's total compensation. Companies will need to implement appropriate recordkeeping procedures to reflect these adjustments.

Transition Guidance

Because 2007 is the first year that companies must apply the Final Rules, the changes made by the Interim Rules will not alter prior year disclosure practices. However, under the Interim Rules, only equity-based awards that are granted during the applicable fiscal year will be reported in the Summary Compensation Table or Director Compensation Table, as the case may be. The use of recognized compensation cost for reporting purposes means that equity-based awards granted in prior years will

[4] In other words, the full grant date fair value determined without regard to the effect of service and vesting requirements.

now be included to the extent the compensation cost of such prior awards is recognized during the reporting year. FASB 123R generally became effective for accounting periods beginning in 2006 and applies to equity-based awards that were not vested prior to 2006. FASB 123R provides alternative methods for recognizing the compensation cost of such pre-2006 awards. However, regardless of which method a company has chosen, the Interim Rules require the use of the "modified prospective transition method."[5] Under that method, a proportionate share of the grant date fair value determined under the prior accounting standard, FASB 123[6], will be recognized, and thus included in a company's compensation disclosure, over the remaining vesting period. However, options and equity awards granted prior to 2006 will not be reported in the Grants of Plan-Based Awards Table.

What to Do?

Simply stated, advance planning is key. Since the Amendments are effective for proxy statements, registration statements and annual reports on Form 10-K that relate to Regulation S-K Item 402 and Item 404 disclosures for fiscal years ending on or after December 15, 2006, public companies should take action immediately to analyze the impact of the amendments on their reporting and disclosure obligations. Some companies will need to implement new recordkeeping procedures to capture the needed information. Moreover, companies may want to revisit their equity award policies and practices, including service and performance-based vesting provisions, in light of the new disclosure requirements.

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The WT&P Securities Practice Group is available to assist you in addressing any questions that you may have regarding the matters discussed in this Alert.

WT&P Securities Practice Group

D. Scott Freed (sfreed@wtplaw.com)

Caitlin W. Gibson (cgibson@wtplaw.com)

Frank S. Jones, Jr. (fjones@wtplaw.com)

George S. Lawler (glawler@wtplaw.com)

Joseph P. Ward (jward@wtplaw.com)

[5] Under the modified prospective transition method of FASB 123, the accounting for new awards and awards that are modified, repurchased or cancelled after the standard's effective date must apply the provisions of FASB 123R.

[6] FASB Statement 123, Accounting for Stock-Based Compensation, October 1995.