SEC FINALIZES AMENDMENTS TO EXECUTIVE COMPENSATION DISCLOSURE RULES

On Wednesday, December 16, 2009, the Securities and Exchange Commission (the "SEC") finalized amendments to the compensation-related disclosure requirements set forth in Item 402 ("Item 402") and Item 407 ("Item 407") of Regulation S-K, which will be effective February 28, 2010. These final amendments were adopted generally in the form proposed in July 2009 (see our memorandum of July 14, 2009, regarding the proposed amendments, which can be found at http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/3053/SEC_Proposes_Amendments_to_Executive_Compensation_Disclosure.pdf) and involve the following three compensation-related issues, discussed in greater detail below:

- *Risk Analysis* — The amendments add a new disclosure rule under Item 402 — separate from the Compensation Discussion and Analysis (the "CD&A") — that requires disclosure about the registrant's overall compensation policies and practices for all employees, but only if such policies and practices create risks that are "reasonably likely to have a material adverse effect" on the registrant. This is in contrast to the proposed amendments, which would have expanded the current CD&A discussion beyond the named executive officers (the "NEOs") and would have required disclosure regarding how the registrant's overall compensation policies and practices for all employees, including employees who are not NEOs, create incentives that may have a material effect on the registrant's risk and the management of that risk.

- *Equity Award Disclosure* — The SEC has returned to the previous, and short-lived, original rules governing the disclosure of stock and option awards that were set forth in the August 2006 overhaul of Item 402. Registrants will now be required to disclose equity awards at their grant date fair value in the year of grant, as opposed to the dollar amount recognized in a given year for financial statement reporting purposes. This amendment has several implications, including (i) the potential for more frequent changes among the NEO group due to large sign-on or retention awards granted during a given year, and related considerations as to whether to include supplemental information disclosing the compensation paid to executives who were excluded in a given year as a result of another executive's large award grant, (ii) the requirement to recalculate the NEOs' total compensation for 2008 and 2007 to reflect the change (although the composition of the NEOs need not be changed), and (iii) the potential need for additional footnote disclosure to the Summary Compensation Table where equity awards are received in respect of an executive's election to forego salary or cash bonuses. Performance-based equity awards, which were not addressed in the proposed amendments, are to be disclosed at their fair market value based upon the probable outcome of the applicable performance condition(s) as of the grant date, with explanatory footnote disclosure regarding the potential maximum value of such awards.

- *Compensation Consultant Disclosure* —Additional disclosure may be required regarding an executive compensation consultant retained by the board of directors (or management's consultant if the board of directors has not engaged a consultant of its own) to the extent that the same consultant or one of its affiliates provides certain other non-executive compensation consulting services to the registrant, such as benefits administration, human resources consulting, or actuarial services, if the fees paid for such other services exceed $120,000 in a given year.

Risk Analysis

In July 2009, the SEC proposed to amend the CD&A rules to require a discussion and analysis of the registrant's broader compensation policies and overall compensation practices for all employees generally, including employees who are not executives, if risks arising from those policies or practices may have a material effect on the registrant. The final amendments adopted by the SEC differ from the proposal in two significant ways: (i) the risk discussion will not be a part of the CD&A, which remains limited to NEO compensation (although the requirements adopt a similar "principles-based" approach to disclosure), and (ii) there is a substantially higher threshold for triggering disclosure, which will now be required only if the compensation policies or practices create risks that are "*reasonably likely* to have a material *adverse* effect" on the registrant. The "reasonably likely" threshold for disclosure is the same as that for the risk-related disclosure requirements contained in the Management Discussion and Analysis rules under Item 303 of Regulation S-K.

To the extent the disclosure threshold is crossed, new Item 402(s) of Regulation S-K will require a discussion of the registrant's overall compensation policies and practices for all employees as such policies and practices relate to risk management and risk-taking incentives. This disclosure, and any determination as to whether it will be required of a given registrant, will necessarily require the registrant to undertake an analysis of the level of risk that its employees might be encouraged to take to meet their compensatory incentive goals. The SEC has explicitly noted, however, that a registrant may under appropriate circumstances conclude that its compensation policies and practices are not reasonably likely to have a material adverse effect on the registrant, in which case no disclosure of risk analysis would be required.

Consistent with the "principles-based" approach of the CD&A rules, which provide examples of information that, if material, might be worthy of disclosure, the final amendments generally adopt the list of scenarios set forth by the proposed rules that might trigger disclosure to the extent that they are reasonably likely to have a material adverse effect on the registrant, as follows:

- where compensation policies and practices are maintained at a business unit that carries a significant portion of the registrant's risk profile;

- where compensation policies and practices are maintained at a business unit with compensation structured significantly differently from that of other units within the registrant;

- where compensation policies and practices are maintained at business units that are significantly more profitable than others within the registrant;

- where compensation policies and practices are maintained at business units where the compensation expense is a significant percentage of revenues; and

- where compensation policies and practices vary significantly from the overall risk and reward structure of the registrant, such as when bonuses are awarded upon the accomplishment of a task, while the income and risk to the registrant from that task extend over a significantly longer period of time.

As with the CD&A rules, the list above is not exhaustive, and there may be other features of a registrant's compensation policies and practices that have the potential to incentivize employees to create risks that are reasonably likely to have a material adverse effect. The adopting release expresses the SEC's intention not to generate generic or boilerplate disclosure relating to risk. If disclosure is required, facts and circumstances will dictate which information is required in connection with the policies and programs to be discussed. The SEC has suggested generally the same nonexclusive list of topics for analysis and discussion that was set forth in the proposed rules, as follows:

- the general design philosophy of the compensation policies for employees whose behavior would be most affected by the incentives established by the policies, as such policies relate to or affect risk-taking by those employees on behalf of the registrant, and the manner of their implementation;

- the registrant's risk assessment or incentive considerations in structuring the policies or in awarding and paying the compensation;

- how the policies relate to the realization of risks resulting from the actions of employees in both the short term and the long term, such as through policies requiring clawbacks or the imposition of holding periods;

- policies regarding adjustments to address changes in risk profile and any material adjustments made as a result of changes in risk profile; and

- the extent to which the registrant monitors its policies to determine whether its risk management objectives are being met with respect to incentivizing employees.

Equity Award Disclosure

The final amendments require, as proposed, that equity awards to NEOs or directors be disclosed in the year of grant in the Summary Compensation Table or Director Compensation Table, respectively, at their grant date fair market value (including, for an NEO, awards received in lieu of salary or bonus at the NEO's election), rather than at the amount recognized in the year of

disclosure for financial statement reporting purposes. Although discussed in the proposed amendment's adopting release, the SEC ultimately decided with the final amendments not to require disclosure of awards granted "in respect of" a given year, as is the case under the subjective requirements for the disclosure of cash bonuses. Instead, equity award disclosure remains wholly objective — awards granted during a given fiscal year must be disclosed for that year, even if they are granted in respect of a prior year's performance. To the extent a registrant views an equity award as having been granted in respect of a year other than the year of grant, it should consider explaining the distinction in its CD&A.

This change, which is effective only for disclosure relating to fiscal years ending on or after December 20, 2009, is largely a reversion to the original rules adopted in August 2006, prior to their sudden amendment in December of that year. Since that amendment, the expense-driven approach for disclosing equity awards has been criticized for providing accounting-based information that many investors do not truly understand and that does not accurately reflect compensation committees' perceptions of compensation amounts being paid currently to executives. Although the composition of the NEO group for 2008 and 2007 will not need to be revised to reflect this rule change, the disclosure of such prior years' equity compensation (and consequently, total compensation) for this year's NEOs who were also NEOs in such prior years must be recalculated for purposes of this year's Summary Compensation Table. We believe that the revised disclosure rules relating to equity compensation will result in a more understandable picture of the value of annual equity compensation awards.

Performance-based awards, which were not addressed by the proposed rules, need not be reported at their maximum value; rather, the value disclosed should be based upon the probable outcome of the applicable performance condition(s) as of the grant date, consistent with the grant date estimate of compensation cost to be recognized over the service period, excluding the effect of forfeitures. Disclosure of the maximum value will, however, be required in a footnote to the applicable table.

Two components of the proposed amendment were not adopted in the final rule. First, the "Grant Date Fair Market Value" column is retained in the Grants of Plan-Based Awards Table. Although the information in this column could have been provided to investors, if necessary, in a footnote to the applicable equity award column in the Summary Compensation Table, the SEC concluded that retaining this column would provide investors with clear disclosure of the value associated with each type of equity award received in a given year. Second, registrants are still required to report in the "Salary" or "Bonus" column of the Summary Compensation Table the grant date fair value of equity awards received at the executive's election in lieu of foregone salary or bonus, respectively. Such awards will continue to be excluded from the "Stock Awards" and "Option Awards" columns.

Compensation Consultants

The amendments to Item 407 may require additional disclosure regarding compensation consultants hired by a registrant. Registrants are currently required by Item 407 to describe the role played by compensation consultants in determining or recommending the form of executive

and director compensation. Among the items currently required to be disclosed are the identity of such consultants, the person or committee charged with engaging the consultants, the nature and scope of the consultants' assignments, and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties. Registrants have not been required to disclose the fees paid to such consultants or their affiliates or to describe any other services provided that are not related to executive or director compensation.

In proposing the amendments, the SEC noted its concern for the potential conflict of interest that might call into question the objectivity of a consultant's executive compensation recommendations. Such a conflict might arise if the same consultant or an affiliate of the consultant provides other services to the registrant, such as benefits administration, human resources consulting, or actuarial services, for which the fees are greater than the fees for the executive compensation consulting.

To address these concerns, amended Item 407 will require disclosure of the fees paid to such compensation consultants if those consultants or their affiliates also provide other services to the registrant (including both the aggregate fees for additional services and the aggregate fees paid for work related to determining or recommending the amount or form of executive and director compensation). Disclosure of fees and the related information described below will be required in respect of any such consultant retained by the board of directors or compensation committee if the fees for the other services exceed $120,000 during the applicable fiscal year. Such disclosure will be required in respect of any such consultant retained by the registrant if the fees for the other services exceed $120,000 during the applicable fiscal year only if the board of directors or compensation committee does not retain its own compensation consultant.

To the extent that additional disclosure is required in respect of a compensation consultant, the registrant will be required to disclose whether the decision to engage the consultant or its affiliates for services not related to executive or director compensation was made, recommended, subject to screening, or reviewed, by management. Unlike in the proposed rules, however, registrants will not be required to describe the nature and extent of such additional services provided by the consultant, due to concerns that such disclosure could cause competitive harm by revealing confidential pricing information. That said, registrants are not prohibited from providing such disclosure to the extent that they conclude that it would facilitate investor understanding of the existence or nature of any potential conflict of interest.

No disclosure will be required with respect to any consultant whose exclusive role in recommending the amount or form of executive or director compensation is in connection with either consulting on broad-based plans that do not discriminate in favor of executive officers or directors, such as 401(k) or health insurance plans, or providing only information that is not customized for a particular company, such as market surveys.

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