

Frederic W. Cook & Co., Inc.

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SEC Releases Interpretive Guidance On New Executive Compensation Disclosure Rules

The staff of the Securities and Exchange Commission on January 24, 2007 issued interpretive guidance on the new executive and director compensation proxy disclosure rules. The guidance is in the form of 28 questions and answers of general applicability to the new rules, as well as 18 interpretive responses regarding particular situations. The guidance replaces previous interpretations issued in 1997 and 1999, and appears to be drafted in a manner that would facilitate periodic future updates as necessary.

Some of the guidance is useful in addressing where to report particular items of compensation that do not fit squarely in a prescribed column, such as cash-denominated incentive plan awards that are paid in company stock. Some of the guidance is surprising, such as the apparent requirement to report reinvested dividends or dividend equivalents paid on restricted stock in the Outstanding Equity Awards at Fiscal Year-End and/or Option Exercises and Stock Vested tables. However, much of the guidance lacks interpretation, such as not providing more charity on when companies may omit disclosure of specific performance targets, and merely recites the seemingly obvious requirements of the new disclosure rules. The interpretative guidance is briefly summarized below.

Compensation Discussion and Analysis

- The Compensation Discussion and Analysis disclosure requirements related to stock option grant timing and exercise price determination are applicable to all types of equity awards (not just stock options), and may require disclosure of grant practices that occurred before or after the last completed fiscal year
- When evaluating whether performance targets may be omitted from disclosure, companies must make the determination based on established standards for what constitutes confidential commercial or financial information, the disclosure of which would cause competitive harm (and nondisclosure is not permitted for information that otherwise has been disclosed publicly)

Summary Compensation Table

- Cash bonuses based on performance criteria that are substantially uncertain and communicated to participants at the onset of the performance period should be reported in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table, regardless of the length of the performance period or whether negative discretion is permissible, and the basis for the use of negative discretion may need to be disclosed in the Compensation Discussion and Analysis

- Discretionary cash bonuses that are not based on any performance criteria should be reported in the Bonus column of the Summary Compensation Table, including amounts paid in excess of amounts earned by meeting the performance criteria in a non-equity incentive plan
- For arrangements in which the named executive officer may elect to receive equity compensation in lieu of what would otherwise be paid in cash, if the amount of salary or bonus forgone is less than the value of the equity compensation received, the incremental value of the equity compensation should be reported in the Stock or Option Awards column of the Summary Compensation Table, as appropriate
- The disclosure of Stock or Option Award valuation assumptions should relate to any award reported in the Summary Compensation Table, not just for awards granted during the last completed fiscal year
- If an equity award is granted after the end of the last completed fiscal year for which it was earned, disclosure of the award should be made in the Compensation Discussion and Analysis for the last completed fiscal year, but the award should not be reported in the Summary Compensation Table or the Grants of Plan-Based Awards table until the following fiscal year in which it was granted (with the amount reported in the Summary Compensation Table being consistent with the amount recognized for finalized statement reporting purposes)
- Companies with multiple pension plans are permitted to aggregate all increases or decreases in the actuarial present value of accumulated pension benefits before applying the “no negative number” provisions applicable to the Change in Pension Value column of the Summary Compensation table
- If the \$10,000 reporting threshold for perquisites is exceeded, each perquisite must be separately identified by type even if there is no incremental company cost (no reporting is required for perquisites that are fully reimbursed by the executive)
- No disclosure is required for compensatory benefits received from non-discriminatory Section 423 employee stock purchase plans
- No disclosure is required for dividends, dividend equivalents, or other earnings on equity awards granted prior to the effective date of the new disclosure rules if the earnings would have been appropriately factored into the grant date fair value of the related award in accordance with FAS 123R
- Nonqualified deferred compensation payouts are not disclosed in the Summary Compensation Table, but rather in the Aggregate Withdrawals/Distributions column of the Nonqualified Deferred Compensation table
- If an employee ceases to be an executive officer during the fiscal year but remains employed by the company, the employee must be included in the Summary Compensation Table if the employee would otherwise be one of the two additional individuals whose total compensation for the year (based on the employee’s compensation for the full year) was higher than the total compensation of the three highest paid executive officers, other than the chief executive officer and chief financial officer, who are treated as named executive officers

Grants of Plan-Based Awards Table

- If an equity incentive plan award is denominated in dollars, but payable in stock, it should be reported in columns (f) through (h) of the Grants of Plan-Based Awards table with footnote disclosure explaining the stock payout provisions (and companies are permitted to change the (#) to (\$) in the column headers if all awards in the column are structured that way)
- For cash awards that are made in the same year they were earned under an annual non-equity incentive plan (and the amounts are disclosed in the Summary Compensation Table), companies are permitted to change “future” to “possible” in the header for columns (c) through (e) of the Grants of Plan-Based Awards table

Outstanding Equity Awards at Fiscal Year End Table

- Dividends or dividend equivalents paid on restricted stock that are credited and reinvested into additional equity awards should be reported in the Outstanding Equity Awards at Fiscal Year-End table while unvested, and in the Option Exercises and Stock Vested table upon vesting

Option Exercises and Stock Vested Table

- The gross number of shares underlying an exercised stock appreciation right should be reported in the Option Exercises and Stock Vested table, not just the net profit shares

Pension Benefits Table

- When a pension plan has a stated “normal” retirement age and an early retirement age at which benefits are paid without any reduction, the early retirement age should be used for determining pension benefits (and the normal age may be included as an additional column)
- The actuarial present value of accumulated pension benefits that vest upon reaching a certain age should assume that the normal retirement age (or early retirement age if applicable) is attained, and should ignore actuarial “pre-retirement decrements”

Nonqualified Deferred Compensation Table

- Earnings on non-qualified deferred compensation are not “above-market” or “preferential” if calculated in the same manner and rate as earnings on externally managed investments for employees participating in a broad-based tax-qualified plan (this position may not be available for supplemental retirement plans that do not have any relationship to a tax-qualified retirement plan of the employer)
- Footnote disclosure of amounts reported in the Nonqualified Deferred Compensation table that were previously reported in the Summary Compensation Table is only required if such amounts were actually previously reported in the Summary Compensation Table

Director Compensation Table

- Director compensation disclosure is required for persons who served as director during the last completed fiscal year but no longer serve as director at year end, or are not standing for re-election the next year
- Director or executive compensation disclosure is not required for an executive officer (who is not a named executive officer) who is also a director and does not receive additional compensation for services as a director (footnote disclosure of this fact is required)

Finally, there is additional guidance in the interpretive responses regarding particular situations that deal with spinoffs, mergers, public offerings, changes in fiscal year end, reload stock options, and parent/subsidiary relationships.

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General questions about this letter can be addressed to Thomas Haines in our Chicago office at 312-332-0910 or by email at tmhaines@fwcook.com, or to Richard Alpern in our New York office at 212-986-6330 or by email at rlalpern@fwcook.com. Copies of this letter and other related materials are available on our website, www.fwcook.com under the following links.

Date	Title	Website Link
February 1, 2006	SEC Proposals On Executive Compensation Disclosure	http://www.fwcook.com/alert_letters/2-1-06_SEC_Proposals-on-Executive-Compensation-Disclosure.pdf
August 14, 2006	Final SEC Rules on Proxy Disclosure of Executive and Director Compensation Effective for 2007 Proxy Season	http://www.fwcook.com/alert_letters/8-14-06_Heads-up_On_Executive_Compensation_Disclosure.pdf
December 28, 2006	SEC Amends Rules on Proxy Disclosure of Equity Awards Effective for 2007 Proxy Season	http://www.fwcook.com/alert_letters/12-28-06_Heads-Up_On_Executive_Compensation_Disclosure.pdf