



D a v i s G r a h a m & S t u b b s L L P

**Client Alert:
New Form 8-K Executive Compensation Disclosures**

November 6, 2006

On September 8, 2006, the Securities and Exchange Commission (“SEC”) released final rules regarding the disclosure of executive and director compensation, related party transactions, director independence, and various other corporate governance matters in proxy statements and other SEC filings (the “Compensation Rules”). This Client Alert is a reminder that, because the Compensation Rules include significant changes to the requirements of Form 8-K concerning disclosure of executive compensation, and those changes are effective for Form 8-K triggering events that occur on or after November 7, 2006, reporting companies need to carefully consider the effect of the changes on their current event reporting obligations. This following is a brief summary of the changes to Form 8-K made by the Compensation Rules, an analysis of their implementation, and some practical recommendations.

Summary of Changes

Changes to Items 1.01 (Entry into a Material Definitive Agreement) and 1.02 (Termination of a Material Definitive Agreement)

Item 1.01 of Form 8-K (Entry into a Material Definitive Agreement) requires disclosure by an Exchange Act reporting company within four days after entry into a “material definitive agreement outside the ordinary course of business” or “any material amendment to such an agreement.” Similarly, Item 1.02 of Form 8-K (Termination of a Material Definitive Agreement) requires disclosure concerning the termination of executive compensation agreements or arrangements, and “material definitive agreement” in Item 1.02 is defined by reference to Item 1.01. Items 1.01 and 1.02 apply to “material definitive agreements” generally, but the final sentence of Instruction 1 to Item 1.01 explicitly included executive compensation arrangements in the definition of material definitive agreement by its reference to Item 601(b)(10)(iii) of Regulation S-K.

While Item 1.01 was intended to elicit only those executive compensation disclosures that were “unquestionably or presumptively material,” the SEC indicates in the final release for the Compensation Rules that it had received many executive compensation disclosures that fell below this standard. Due to the perceived ambiguity as to which executive compensation arrangements should be disclosed on Form 8-K, and the resulting influx of disclosures that did not meet the “unquestionably or presumptively material” standard, the Compensation Rules uncouple Items 1.01 and 1.02 from Item 601(b)(10)(iii) of Regulation S-K. By so doing,

employment compensation arrangements are now removed entirely from Items 1.01 and 1.02 of Form 8-K.

Expansion of Item 5.02 (Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements for Certain Officers)

Instead of treating executive compensation issues like other material agreements under Items 1.01 and 1.02, Form 8-K now addresses them in an expanded Item 5.02 (Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements for Certain Officers).

Named Executive Officer. Amended Item 5.02 incorporates the concept of “named executive officer” from the proxy rules. The term encompasses those persons for whom compensation disclosure was required in the company’s most recently filed proxy statement, Form 10-K or registration statement.

New Item 5.02(e) – Material Compensatory Plan, Contract or Agreement. New Item 5.02(e) requires a Form 8-K to be filed whenever the principal executive officer, principal financial officer, or any named executive officer participates in a new “material compensatory plan, contract or arrangement” with the company, or such a material compensatory plan, contract or arrangement is “materially amended or modified.” The material compensatory plan, contract or arrangement being established or materially amended does not have to take the form of a written document.

Information to be Disclosed. All Item 5.02 disclosures are to be made by a “brief description,” which in the case of paragraph (e) includes the terms, conditions and amounts payable to the named executive officer. Disclosure is *not* to be made by the fuller narrative disclosures required for executive compensation in a proxy statement, Form 10-K or registration statement. Additionally, subsection (e) mandates disclosure whenever a “material grant or award” under an above-mentioned material compensatory plan, contract or arrangement is made or materially amended. However, Instruction 2 to subsection (e) states that no disclosure is required if the grant or award made or modified is “materially consistent” with the previously disclosed terms of a material compensatory plan, contract or arrangement.

Safe Harbor for Item 5.02(e). In March 2004, the SEC provided a limited safe harbor from liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder for failure to timely file certain Form 8-K disclosures. The safe harbor protects a company from liability for violations of the Rule 10b-5 antifraud provisions so long as the required disclosure is made by or on the company’s filing due date for the quarterly or annual report for the period in question. The disclosure must be made in the 10-Q or 10-K covering the period in which the disclosure should have occurred or in a separate Form 8-K. The Compensation Rules extend this safe harbor to disclosures made in accordance with Form 8-K Item 5.02(e).

Additionally, a company can forfeit its eligibility to use the Form S-3 if it fails to timely file all reports required under the Exchange Act during the 12 months prior to the filing of the registration statement. Under the Compensation Rules, a safe harbor for Form S-3 eligibility

also applies to Item 5.02(e) so long as the disclosure is made by or on the company's filing due date for the quarterly or annual report for the relevant period.

Safe Harbors Apply to Item 5.02(e) Only. The safe harbors for antifraud liability and Form S-3 eligibility apply *only* to Item 5.02(e) and *not* to any of the other disclosures required by new Item 5.02.

Revised Item 5.02(b) – Resignation, Retirement or Termination. The Compensation Rules amend Item 5.02(b) to require Form 8-K disclosure upon the retirement, resignation or termination of a company's (1) principal executive officer, (2) president, (3) principal financial officer, (4) principal accounting officer, (5) principal operating officer, (6) any other person performing similar functions, or (7) a named executive officer. The disclosure need only be a brief description of the fact that the event occurred and the date of the event.

Revised Item 5.02(c) – Appointment of Officers. Under the old rules, Item 5.02(c) required disclosure by way of a brief description of the material terms of any employment agreement between the company and the (1) principal executive officer, (2) president, (3) principal financial officer, (4) principal accounting officer, (5) principal operating officer, or (6) any other person performing similar functions. Under amended Item 5.02(c), the disclosure must now include, similar to Item 5.02(e), a brief description of any "grant or award," "material plan, contract or arrangement," or any modification thereto, to which any of the above parties is a participant. However, the new Item 5.02(c) does *not* contain an instruction, such as with Item 5.02(e), removing the disclosure requirement for grants or awards "materially consistent" with previously disclosed terms.

Revised Item 5.02(d) – Appointment of Directors. Under the old rules, Item 5.02(d) required certain disclosures whenever the company appointed a director other than by a vote of security holders at an annual meeting or special meeting convened for that purpose. Under the new amended Item 5.02(d), the company must briefly describe any "grant or award," "material plan, contract or arrangement," or any modification thereto, to which the director is a participant. As with Item 5.02(c), Item 5.02(d) does *not* contain an instruction removing the disclosure requirement for grants or awards "materially consistent" with previously disclosed terms.

New Item 5.02(f) – Previously Omitted Salary and Bonus Disclosures. New Item 5.02(f) requires disclosure of a named executive officer's salary or bonus, which was omitted from the Summary Compensation Table because it was not available when the company filed its last proxy or annual report, when the salary or bonus becomes calculable. The Form 8-K disclosure must also include the named executive officer's newly calculated total compensation figure. There is no distinction between cash or equity based plans when considering the need for disclosure.

General Instruction D. Under the old rules, General Instruction D allowed a company to file a single Form 8-K to satisfy one or more disclosure items so long as the company identified by item number and heading all of the applicable items being satisfied and provided all of the substantive disclosures required by each of the items. The Compensation Rules liberalize General Instruction D to provide that a Form 8-K filing may omit the Item 1.01 heading if

multiple items in addition to 1.01 are applicable, assuming all of the substantive disclosures required under Item 1.01 are satisfied under another heading.

Analysis

The Compensation Rules intend to improve upon the disclosure requirements under Form 8-K Items 1.01 and 1.02 by concentrating the executive compensation provisions in Item 5.02 and clarifying which agreements satisfy the standard of “unquestionably or presumptively material.” However, the Compensation Rules simply seem to have perpetuated some ambiguity under the new formulation of “material compensatory plan, contract or arrangement.” While this formulation improves on the old one by removing the “outside the ordinary course of business” concept, it does little to address the uncertainty of what satisfies the “unquestionably or presumptively material” standard. As a result, companies must still evaluate the materiality of a compensation plan, contract or agreement on a case-by-case basis.

Similarly, the Compensation Rules provide little guidance as to which awards or grants will escape the disclosure requirements of 5.02(e) because they are “materially consistent” with previously disclosed terms and therefore exempted by Instruction 2. Apparently, Instruction 2 intends to limit the application of 5.02(e) to only those awards or grants that are new or significantly different than those previously disclosed. While the Instruction aims to alleviate the burden on companies by eliminating disclosure for slight modifications in awards or grants, the ambiguity of the “materially consistent” standard removes the burden only for truly *de minimis* modifications.

Practical Recommendations

In order to comply with the Compensation Rules for executive compensation disclosures under Form 8-K, public company management may wish to consider some or all of the following actions:

- Review existing executive compensation arrangements with your directors and named executive officers to determine if any aspects not yet disclosed are subject to the amended Form 8-K.
- Prior to filing any quarterly or annual report, specifically consider whether any Item 5.02(e) disclosures should have been made during the preceding quarter. Failure to make any such disclosures could endanger the safe harbors for antifraud liability and Form S-3 eligibility that could otherwise have been preserved.
- Modify the design of your disclosure controls and procedures so that the trigger events for Item 5.02(b), (c) or (d), such as the hiring, promotion, termination, resignation, or retirement of any employee that has been or may be considered a named executive officer or director, will immediately elicit consideration of whether a Form 8-K disclosure is required. The 4-day window is short and could lapse unless the disclosure inquiry receives immediate attention.

- When a triggering event for Item 5.02(b), (c) or (d) disclosure occurs and it is unclear whether a modification to an award or grant is materially consistent with a prior disclosure, establish a policy of protecting your interests by filing a Form 8-K disclosure within 4 days of the triggering event.
- Modify your disclosure controls and procedures to provide that the appropriate company officer has an updated list of those officers and directors for whom any compensation change could potentially necessitate a Form 8-K disclosure.

The text of the final rules is available at <http://www.sec.gov/rules/final/2006/33-8732afr.pdf>.

Peter H. Schwartz
S. Lee Terry, Jr.
Ryan D. McGee

The DGS Corporate Finance & Acquisitions Group has worked extensively with boards and audit committees to work through difficult disclosure and financial reporting issues, and would be happy to consult with you on your needs in this particularly uncertain regulatory environment.

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