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B&B REVIEW

Corporate and Securities

SEC Issues Guidance on Determining What is a "Perquisite" for Current Proxy Statements

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INTRODUCTION

This morning, the Securities and Exchange Commission issued its 372-page proposal for proxy statement disclosure of executive compensation. Most of the proposal is prospective in nature and would not apply to proxy statements for 2006 stockholder meetings currently being drafted, although some companies may choose to adopt some of the proposals immediately as best practices.

Significantly, the SEC has included in its proposal several pages of "interpretive guidance" on "perquisites and other personal benefits". This guidance is effective immediately, and therefore would apply to the disclosures of such items made in proxy statements currently being drafted, even if related matters are subject to existing rules for disclosure. The guidance reflects the SEC's overall attitude toward executive compensation disclosure in that it encourages an approach of substance over form. That is, for determining what is a perquisite, the SEC has rejected "bright line" tests that can encourage circumvention of the general intent of full disclosure over time, in favor of more general principles-based guidance.

Notwithstanding its rejection of a bright line test for its guidance on what is a "perquisite", there are a great many new such tests that are being proposed in the SEC's release on a wide variety of executive compensation disclosure topics, including the specific types of disclosure required for perquisites in addition to the more generalized guidance. Comments on all of the proposed new disclosure rules will be due at the end of March 2006.

RECAP OF EXISTING PERQUISITE DISCLOSURE RULES FOR CURRENT PROXY STATEMENTS

One of the most important rules on perquisite disclosure has been what can be omitted altogether on a "*de minimis*" basis. The current rules permit omission of perquisites and other personal benefits if the aggregate amount of such compensation is the lesser of either $50,000 or 10% of annual salary and bonus. The SEC believes that this rule permits the omission of too much information that investors would find material.

A second very important rule on disclosure is which perquisites and personal benefits must be separately identified and valued. The current rule is that only such items that constitute 25% or more of the total amount for each named executive officer must be identified and quantified.

Finally, once a perquisite is disclosed and valued, a key question is how it is described. Current rules are not specific as to the level of detail required. In this area, the SEC has had to utilize enforcement actions such as that brought recently against Tyson Foods. There, the SEC objected to the company's description of such company-provided benefits as clothing, jewelry, artwork, theater tickets and housekeeping services as "travel and entertainment".

The SEC's proposed new rules would address each of the above rules, in each case making it more likely that more items will have to be disclosed and more particularly described.

NEW TOUCHSTONE FOR DETERMINING WHAT IS A PERQUISITE: "INTEGRALLY AND DIRECTLY RELATED TO PERFORMANCE OF DUTIES"

The SEC has articulated a rather simple, yet narrow, rule for guiding issuers in determining what is a perquisite or other personal benefit. If an item of compensation or other benefit can be characterized as "integrally and directly related to the performance of duties", then it is not a

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perquisite or other personal benefit. This standard does not allow for use of a number of other attributes for compensation that are used in other contexts for determining the treatment of the compensation. For example, it is considerably narrower than the "ordinary and necessary" standard used for determining whether an item of compensation can be deducted by the employer for federal income tax purposes.

Importantly, the new standard does not include items of compensation that actually may "facilitate" job performance, if they are not "directly and integrally related" to performance.

Finally, the SEC's approach also rejects a concept of not characterizing something as a perquisite if it is primarily for the convenience or benefit of the company.

As noted above, the new "directly and integrally related" standard is in effect immediately even if the new rules for thresholds and separate valuations and descriptions, summarized below, are not yet effective.

WHAT IS "INTEGRALLY AND DIRECTLY RELATED"

Despite the SEC's desire not to engage in a rules-based regime for determining what is and is not a perquisite or other personal benefit, it has provided a few examples of what would and would not meet this test. Perhaps not surprisingly, the list of what is not a perquisite or personal benefit is much shorter than the list of what would be.

None of the following would be considered a perquisite or personal benefit, so long as it were "directly and integrally related to job performance":

-- Larger or additional **office space**;
-- **Secretarial service** at a higher level than other employees;
-- Reserved **parking spaces** that are closer to business facilities than other spaces;
-- **Travel** to and from **business meetings** (but see discussion below on corporate aircraft travel);
-- **Business entertainment**; and
-- **Security during business travel**.

WHAT IS *NOT* "INTEGRALLY AND DIRECTLY RELATED"

Anticipating what many issuers might attempt to use as additional standards for determining what is a perquisite, the SEC has provided a rather long list of compensation or other benefits that would fall outside of their "integrally and directly related" category:

Items that merely facilitate job performance:

-- use of company-provided **aircraft**, even if to help ensure the personal security of the executive;
-- use of company-provided yachts and other **watercraft**;
-- use of company-provided commuter transportation services (i.e., **limousines**);
-- additional **clerical or secretarial services** devoted to **personal matters**; and
-- **investment management or financial planning** services.

The SEC has also listed as perquisites the following examples of items that traditionally have been thought to serve primarily a business purpose or to be for the convenience primarily of the employer and having only an incidental personal benefit to the executive:

-- **club memberships** not used exclusively for business entertainment;
-- **personal travel** using vehicles used or leased by the company (even if for reasons of personal security for the executive);
-- **relocation** assistance;
-- **security** provided at a personal residence or during personal travel; and
-- **discounts** on company products not generally available to employees on a non-discriminatory basis.

SUMMARY OF PROPOSED NEW PERQUISITE DISCLOSURE RULES

As noted above, once an item of compensation or a service is labeled as a "perquisite or other personal benefit", there are three sets of rules to be reckoned with in deciding what to disclose in the proxy statement: (1) what can be omitted on a *de minimis* basis, (2) what must be separately identified and valued; and (3) how much of a description is required.

De Minimis Omission. The SEC's proposal would change the omission rule so that disclosure would be required if the aggregate amount of perquisites and other personal benefits were $10,000 or more.

Separate Identification and Valuation. The new test for what must be separately identified and valued, once the $10,000 threshold is met, would be that each item must be separately identified, and must be separately valued as well if it is valued at the greater of $25,000 or 10% of total perquisites and other personal benefits.

Content of Description. The proposal would require that all perquisites be "described in a manner that identifies the particular nature of the benefit received".