

CORPORATE AND SECURITIES LAW

Alert

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Discretionary Anti-Dilution Provisions in Equity Awards May Trigger Unexpected Compensation Charges

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Leading U.S. accounting firms have recently announced that companies may incur significant and unexpected compensation charges to earnings in connection with discretionary adjustments made to equity awards upon the company completing a capital restructuring, such as a stock-split, extraordinary dividend, spin-off, split-off or recapitalization. This guidance is a departure from prior accounting guidance in FASB Interpretations No. 44, which provided that no expense would be recognized with respect to modified equity awards so long as the intrinsic value of the award was preserved. The guidance relates only to anti-dilution provisions that affect “equity restructurings,” which are nonreciprocal transactions between a company and its shareholders that cause the per share value of the stock underlying an option or similar equity incentive award to change. It does not relate necessarily to award adjustments in the case of business combinations, such as mergers and acquisitions, which are often lumped in with equity restructurings in a plan’s anti-dilution provisions.

Under the new guidance, an anti-dilution adjustment made in anticipation of, or concurrent with, a capital restructuring will result in a compensation charge to the company’s earnings if (i) the value of outstanding awards would have been diminished without the adjustment and (ii) the terms of the equity plan or underlying award agreements do not require the adjustment. Specifically, the recent guidance provides that adjustments made pursuant to anti-dilution provisions which merely permit, but do not require, the adjustment will trigger these charges.

As a result of this new accounting guidance, we urge companies to review their equity plans and underlying award agreements and consult with their external auditors and outside counsel to determine whether or not amendments are necessary to avoid these unexpected accounting charges in connection capital restructurings and any related adjustments to equity awards. It is important to note, however, that an amendment to an equity plan or the underlying award agreements will not be effective in eliminating the charge resulting from an adjustment if such amendment is made in anticipation of a capital restructuring. Thus, companies that are considering a stock-split or other

capital restructuring in the immediate future should seek immediate advice from their external auditors as to whether such amendments will trigger the unwanted accounting charge.

When considering an amendment to their equity incentive plans, companies should also consider the application of the incentive stock option rules and the recently enacted deferred compensation rules under Section 409A of the Internal Revenue Code as well as the possible need for shareholder or option holder approval to any amendments to equity plans and outstanding awards.

If you have any questions about this Corporate and Securities Law Alert, or would like any additional information, please contact any Bass, Berry & Sims attorney in the Corporate and Securities Practice Area.

The materials contained herein have been abridged from the statutory sources and should not be construed or relied upon for legal advice. Readers are urged to consult legal counsel concerning particular situations and specific legal questions.

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