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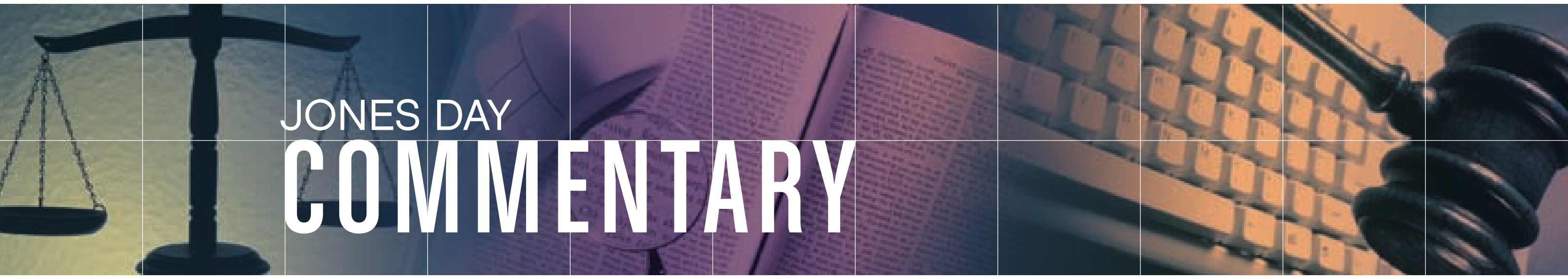

EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION

NEW PENSION FUNDING AND ACCOUNTING RULES BARRAGE EMPLOYERS: CREDIT AGREEMENT AND SEC DISCLOSURE IMPACT

The number of defined benefit pension plans and the employees they cover have been steadily decreasing ever since Congress tried in 1974 to reinforce the benefits provided by these plans with the adoption of the Employee Retirement Income Security Act ("ERISA"). Attempts since then by Congress and government regulators to shore up the private defined benefit pension system have instead accelerated its decline. Recent actions with respect to these plans may well continue this process as the convergence of a new pension funding law and new financial statement disclosure rules provides new challenges for employers that still sponsor pension plans.

PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006 ("PPA") was enacted with the stated purposes of improving the funding of America's private pension plans, thereby improving the financial future of the Pension Benefit Guaranty Corporation, and better securing the retirement promises made by employers to employees. To achieve these purposes, the PPA imposes new, stringent pension funding requirements.

Those employers with the financial wherewithal to meet the new funding requirements will end up with well-funded plans. However, attaining this well-funded status may have a significant impact on cash flow, as many employers will be required to contribute amounts in the next few years well in excess of amounts they would have expected to contribute under current law. Future contribution obligations also likely will be more volatile and less predictable for many plans. Higher contributions and greater volatility will be magnified for employers with plans that continue to accrue additional benefits in the future.

FASB STATEMENT NO. 158

The Financial Accounting Standards Board ("FASB") also just took its first major step in the process of revising the financial statement disclosure requirements relating to defined benefit pension and other postretirement plans. FASB Statement No. 158 ("FAS 158") requires employers to recognize a plan's funded status on their balance sheets for the first time. For publicly traded companies, this change is effective for fiscal years ending after December 15, 2006 (*i.e.*, effective for 2006 financial statements of calendar-year companies).

Previously, the funded status of plans was disclosed in financial statement footnotes. For purposes of the new rule, a pension plan's funded status is to be measured as the difference between plan assets and the plan's *projected* (rather than accumulated) benefit obligation, meaning that the benefit liability will reflect assumed future pay increases, rather than simply benefits accrued to date. FAS 158 also applies to postretirement medical and other welfare benefit plans but permits these plans to measure their *accumulated* postretirement benefit obligation. For many companies, FAS 158 reportedly will result in reductions in balance-sheet shareholder equity.

IMPACT ON COMPANIES

Companies will need to deal with the PPA and FAS 158 on many fronts: legal, finance, accounting, and human resources. We see two major impacts that call for immediate attention.

Debt Covenants. FAS 158 will change the balance sheets of companies with defined benefit pension plans or postretirement medical plans. A company with a credit agreement, indenture, or other debt agreement that contains representations, covenants, or events of default that key off of the balance sheet needs to assess the impact of the FAS 158 changes. Waivers from lenders or amendments to credit documents may be necessary, and in some instances, consents from noteholders may be required.

The PPA also could affect debt documents because it may require plan sponsors to contribute larger amounts to their pension plans. If the representations, covenants, or events of default under a company's debt documents relate to cash reserves or cash flow measures, the PPA could have a big impact. Again, the company may need to approach its creditors and noteholders for relief.

There may be more in this regard waiting in the wings. The next round of FASB revisions to accounting standards regarding pensions and other postretirement plans may raise more issues. The FASB continues to study how companies are required to determine periodic pension and other postretirement benefit plan costs (*i.e.,* annual expense) and how plan assets and liabilities are measured.

SEC Disclosure Requirements. The PPA and FAS 158 will prompt obvious changes to the financial statements and related footnotes of companies with affected plans. In addition, SEC filings will likely be affected as follows:

- *Impact of change in accounting standard*. FAS 158 will likely lead to disclosure, in the Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A"), of critical accounting estimates as well as changes in accounting standard for companies with pension and other postretirement benefit plans. FAS 158 also may affect a company's ability to pay dividends, subject to certain corporate law considerations. To the extent a company has previously disclosed its intent to pay such dividends, it should reevaluate its dividend policy and rethink its disclosure in light of the adoption of FAS 158.

- *Impact of pension-related cash flows*. MD&A disclosure related to cash flows will also likely be affected as the PPA's new funding rules kick in. Generally, SEC rules require disclosure in "Liquidity and Capital Resources" of future liquidity issues. The potentially significant cash flow impact for employers that will be required to contribute amounts to plans in excess of amounts they would have expected to contribute prior to enactment of the PPA will likely need to be discussed as a matter negatively affecting liquidity.

- *Impact on debt documents*. Amendments to debt documents will, in many circumstances, trigger the obligation to file a Current Report on Form 8-K. In addition, as debt documents are amended or as covenants are either waived or otherwise not complied with, related disclosure may need to be added to the MD&A in the discussion of liquidity.

CONCLUSION

The impact of the PPA and FAS 158 may be significant, particularly for companies with publicly traded equity securities. In particular, as the effective date for FAS 158 quickly approaches, calendar-year companies should begin evaluating, sooner rather than later, what will be necessary to comply with its requirements.

Adjusting pension and other benefit programs to account for the effect of the PPA and FAS 158 also will be major agenda items for much of American business. In future *Commentaries*, we will discuss in more depth the cash flow implications of the PPA, the plan design choices that will face employers, and the benefits and burdens of those choices.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General e-mail messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Daniel C. Hagen
1.216.586.7159
dchagen@jonesday.com

Jeffrey S. Leavitt
1.216.586.7188
jleavitt@jonesday.com

Michael K. Blais
1.214.969.4564
mkblais@jonesday.com

Gina K. Gunning
1.216.586.1382
gkgunning@jonesday.com