

NYSE COMMITTEE RECOMMENDS NEW CORPORATE GOVERNANCE RULES

By Celeste Rasmussen

Earlier this month, the NYSE's Corporate Accountability and Listing Standards Committee recommended additional listing standards for companies whose securities are traded on the NYSE. The NYSE is currently seeking public comment on the Committee's corporate governance recommendations and intends to submit the recommendations to the NYSE's board of directors for approval on August 1, 2002. Upon approval by the NYSE's board, the recommendations will be submitted to the SEC for final approval.

The proposed new requirements, which the NYSE expects to be adopted by the end of the year, include the following:

Independence of Directors

Central to the Committee's recommendations is a provision that would require boards of NYSE-listed companies to be comprised of a majority of independent directors; currently, NYSE-listed companies are only required to have three independent directors on their boards. As proposed, companies would have a two-year transition period within which to satisfy this requirement.

The recommendations would also tighten the definition of "independent director." For example, for a director to be deemed "independent" under the Committee's proposals, the board must determine that the director has no material relationship with the company, either directly as an officer or employee of the company, or indirectly as a shareholder, officer, or director of an organization that has a relationship with the company.

In addition, the proposals would require a five-year "cooling-off" period for former employees of a company as well as for persons affiliated with the company's auditor; that is, a former employee or auditor of the company would not be deemed an "independent director" until five years after the employment or auditing relationship has ended. This cooling-off period would also apply to a non-employee director who has an immediate family member either employed by the company or affiliated with the company's auditor; such a director would not be considered an independent director until five years after the termination of the relative's employment or auditing relationship.

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Also, under the Committee's proposals, a company's independent directors would be required to meet separately at regularly scheduled "executive sessions." The independent directors would be required to designate, and publicly disclose the name of, one director to preside at such sessions. These sessions would be held without management present so as to facilitate more open discussion among the company's non-management directors.

Board Committees

The Committee's proposals would require NYSE-listed companies to have:

- a nominating/corporate governance committee responsible for new director and board committee nominations and for shaping the company's corporate governance; and
- a compensation committee responsible for executive compensation matters.

As proposed, each committee would be required to consist entirely of independent directors. In addition, each committee would be required to have a written charter providing for, among other duties and responsibilities, an annual performance review of the committee.

Audit Committee Qualifications and Responsibilities

Under current NYSE listing standards, all of the members of a company's audit committee must be "independent" and "financially literate." The proposed rules would add to these standards by requiring the audit committee chairperson to have "accounting or related financial management expertise." In addition, an audit committee member's compensation from the company would be limited to director's fees.

The Committee's proposals would also make significant changes to the responsibilities of audit committees. For example, under the proposals audit committees would have the sole responsibility for the hiring and firing of the company's auditors, including the negotiation of fees and other terms. In addition, audit committees would have the authority to approve any significant *non-audit* relationships with the independent auditors, such as consulting arrangements. The audit committee of a NYSE-listed company would also be subject to an annual performance evaluation. These, as well as the other additional responsibilities recommended by the Committee, would be required to be set forth in the audit committee's written charter.

Other Recommendations

The Committee also recommended other corporate governance rule changes for NYSE-listed companies, including the following:

- shareholder approval of all stock option and equity-based compensation plans, including approval of material revisions to such plans;
- adoption and disclosure of a code of business conduct and ethics for directors, officers, and employees, as well as "prompt" disclosure of any waivers granted to directors or executive officers;
- disclosure on the company's website of the company's corporate governance guidelines, board committee charters, and code of business conduct, as well as disclosure in the company's annual report that these items are available on the company's website; and
- an annual certification from the company's CEO to the NYSE, including certifications that (i) the CEO is not aware of any violation of the NYSE's listing standards; (ii) the company has established and implemented procedures for verifying the accuracy and completeness of information provided to investors; and (iii) the CEO has no reason to believe that the information provided to investors is not materially accurate and complete.

A PDF download of the entire text of the Committee's proposals is available at the following web address: <http://www.nyse.com/abouthome.html?query=/about/report.html>.

NASDAQ PROPOSES NEW CORPORATE GOVERNANCE RULES

By Amos J. Oelking III

The Nasdaq Stock Market recently approved several key corporate governance rule changes. The proposed changes, which have been forwarded to the SEC for final approval and will be subject to public comment, may become effective for Nasdaq companies later this summer. Significant provisions of the proposed new rules are as follows:

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Definition of "Independent Director"

Nasdaq rules currently require companies to have an audit committee of at least three members, comprised solely of "independent directors." Under current Nasdaq Rule 4200, relationships which are a bar to "independent director" status include:

- receipt of compensation from the company in excess of \$60,000 during the previous fiscal year (except for board service); and
- payments between the company and a "for-profit" entity with which the director is associated in excess of the thresholds stated in the rule.

The Nasdaq proposals would extend the \$60,000 compensation prohibition to include:

- the receipt of payments in excess of \$60,000 by an *immediate family member* of a director; and
- *any payments*, including political contributions, in excess of \$60,000 (other than compensation for board service).

The Nasdaq proposals would also delete the phrase "for-profit" from the rule governing payments to other entities so as to capture payments to charities and other not-for-profit organizations with which the director is associated. Moreover, Nasdaq proposes to clarify that these rules would also apply to payments made in the *current* fiscal year.

Stock Option Grants to Directors and Officers

Current Nasdaq Rule 4350 generally requires shareholder approval for all plans in which directors or officers participate, with an exception for so-called "broad based" plans in which a majority of the participants are not officers or directors. Nasdaq's proposals would eliminate this exception, thus requiring shareholder approval of all plans in which officers or directors participate. The proposals would also prohibit, absent shareholder approval, the grant of options to directors and officers for the lesser of 1% of the company's outstanding shares or 25,000 shares (the "de minimis" exception), as well as the use of treasury shares to fund director and officer options (the "treasury share" exception).

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The remaining exceptions set forth in Rule 4350 would be retained, including the exception for grants of stock options to new executive officers. However, such "inducement grants" would be subject to approval by either (i) a compensation committee comprised solely of independent directors, or (ii) a majority of the company's independent directors.

Related Party Transactions

Current Nasdaq Rule 4350(h) requires that all related party transactions be reviewed by the company's audit committee or a "comparable body" of the company's board. As proposed, amended Rule 4350(h) would require that the audit committee or similar committee both review *and approve* all related party transactions.

"Going Concern" Opinions

Nasdaq's proposals would also amend Rule 4350(b) to require that issuers announce through the news media the receipt of an audit opinion with a "going concern" qualification.

Delisting

Finally, the Nasdaq's proposals would amend Rule 4330 to clarify that a company may be delisted from Nasdaq if it fails to provide information requested by Nasdaq or if it makes a communication to Nasdaq containing a material misrepresentation or omission.

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A second round of corporate governance reforms will be considered at the next meeting of the Nasdaq Listing and Hearing Review Council to be held June 26th-28th. The reforms to be discussed include:

- mandating that a majority of board members be independent directors;
- requiring that compensation committees be composed solely of independent directors;
- expanding the scope of audit committee authority; and
- strengthening continuing education for directors.

Please remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues you may contact the head of our Corporate and Securities practice group:

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