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New NYSE and NASDAQ Rules Concerning Shareholder Approval of Equity Compensation Plans

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On June 30, 2003, the Securities and Exchange Commission approved new rules adopted by the New York Stock Exchange and the NASDAQ Stock Market concerning shareholder approval of equity compensation plans, including stock option plans. In general, the rule changes close many of the loopholes which previously existed and which permitted companies to adopt certain equity compensation plans without shareholder approval. The SEC also approved a change in the NYSE rules prohibiting brokers that are members of the Exchange from voting on equity compensation plans unless the beneficial owner of the shares has given voting instructions. NASD rules do not provide for broker voting on any matters, so the NYSE's rule is now consistent with the NASD for equity compensation plans.

The new NYSE and NASDAQ rules, which provide comprehensive shareholder approval requirements for equity compensation plans of companies which are subject to their listing standards, are reasonably consistent but not identical. Each set of rules is summarized below.

The NYSE Rules

Shareholder Approval Requirement. All equity compensation plans that provide for the delivery of equity securities (either newly issued or treasury shares) to any employee, director or other service provider as compensation for services, are subject to shareholder approval, with limited exceptions. Generally, pre-existing plans adopted prior to the SEC's approval of the NYSE rules are "grandfathered" and do not require shareholder approval unless the plans are materially revised. Special transition rules do, however, require shareholder approval of pre-existing (i) "evergreen formula" plans that either were not previously approved by shareholders or do not have a term of 10 years or less and (ii) discretionary plans that contain no limit on the number of shares available. An equity plan requirement that grants be made from treasury shares will no longer eliminate the need for shareholder approval.

- *Material Revisions.* Shareholder approval is also required when plans are "materially revised." A "material revision" of an equity compensation plan includes (i) a material increase in the number of shares available under the plan (formulaic increases or grants are excepted if the plan's term does not exceed 10 years), (ii) an expansion of the types of awards available under the plan, (iii) a material expansion of the class of plan participants, (iv) a material extension of the term of the plan, (v) a material change to the method of determining the strike price of options under the plan or (vi) the deletion or limitation of any plan provision that prohibits repricing (plans that do not specifically permit repricing are considered to prohibit it).

Exclusions and Exemptions. Plans that are generally available to shareholders, such as dividend reinvestment plans, and plans through which individuals can purchase shares at the current fair market value, are not considered "equity compensation plans." Also, the following items are exempted from the shareholder approval requirement, provided that the company's independent compensation committee or a majority of its independent directors approve the grant or plan in question and the company notifies the Exchange in writing when it uses the exemption:

- *Qualified Plans, ESPPs and Parallel Excess Plans.* Plans that are qualified under Section 401(a) or Section 423 of the Internal Revenue Code, *i.e.* ESOPs and ESPPs, are exempt from the NYSE shareholder approval requirement. Companies should note, however, that such plans may independently require shareholder approval under the Code. Parallel excess plans, which are nonqualified plans that provide excess benefits over those permitted in qualified plans, are exempt if the plan meets certain requirements.
- *Employee Inducement Awards.* An award of options or other equity-based compensation as a material inducement to a person being hired (or rehired following a *bona fide* period of non-employment) is exempt from the shareholder approval requirement. Following such a grant, however, the listed company must issue a press release disclosing the material terms of the award.
- *Mergers and Acquisitions.* Conversion of options and other awards to reflect a transaction does not require shareholder approval. Also, shares available under certain plans acquired in corporate transactions may be used for post-transaction grants without further shareholder approval if certain requirements as to the number of shares, term of the plan and individuals who may receive awards are satisfied.

Broker Voting. The prohibition on broker voting without direction by beneficial owners will be effective for any shareholder meeting that occurs on or after the 90th day following the date of the SEC's order approving the rule change.

The NASDAQ Rules

Shareholder Approval Requirement. All stock option and equity compensation arrangements that provide for the acquisition of options or stock by officers, directors, employees or consultants are subject to shareholder approval, with limited exceptions. Generally, pre-existing plans adopted prior to the SEC's approval of the NASDAQ rules are "grandfathered" and do not require shareholder approval unless the plans are materially amended.

- *Material Amendments.* Shareholder approval is also required when a stock option plan or equity compensation arrangement is "materially amended." A "material amendment" of a plan includes (i) a material increase in the number of shares to be issued under the plan (formulaic increases or grants are excepted if the plan's term does not exceed 10 years), (ii) any material increase in benefits to participants, such as a change to permit a repricing, reduce the price at which shares or options may be purchased, or extend the duration of the plan, (iii) a material expansion of the class of plan participants and (iv) an expansion of the types of awards available under the plan.

Exclusions and Exemptions. The following items are exempted from the shareholder approval requirement. NASDAQ is considering a requirement that issuers notify it in writing when using one of the exemptions.

- *Shareholder Plans.* Warrants or rights issued generally to all shareholders, or stock purchase plans available equally to all shareholders, such as dividend reinvestment plans, are exempt from the NASDAQ shareholder approval requirement. Also, plans through which individuals can purchase shares at the current fair market value are exempt from the NASDAQ shareholder approval requirement.

- *Qualified Plans, ESPPs and Parallel Nonqualified Plans.* Plans that are qualified under Section 401(a) or Section 423 of the Internal Revenue Code, *i.e.* ESOPs and ESPPs, are exempt from the NASDAQ shareholder approval requirement, provided that the plans are approved by the company's independent compensation committee or a majority of its independent directors. Companies should note, however, that such plans may independently require shareholder approval under the Code. Parallel nonqualified plans, which are nonqualified plans that provide excess benefits over those permitted in qualified plans, are exempt from the NASDAQ shareholder approval requirement, provided that the plans are approved by the company's independent compensation committee or a majority of its independent directors.
- *Employee Inducement Awards.* An award of options or other equity-based compensation as a material inducement to a person being hired (or rehired following a *bona fide* period of non-employment) is exempt from the shareholder approval requirement, provided that the award is approved by the company's independent compensation committee or a majority of its independent directors.
- *Mergers and Acquisitions.* Conversion of options and other awards to reflect a transaction does not require shareholder approval. Also, shares available under certain plans acquired in corporate transactions may be used for post-transaction grants without further shareholder approval if certain requirements as to the number of shares, term of the plan and individuals who may receive awards are satisfied.

Companies should assess their equity compensation plans in light of the new rules.

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