

Client Alert

NYSE Proposes Amendments to Corporate Governance Rules

Introduction

On November 23, 2005, the New York Stock Exchange proposed amendments to its corporate governance rules contained in Section 303A of the NYSE Listed Company Manual to clarify some of the disclosure requirements and to codify certain interpretations made by the NYSE since Section 303A was originally adopted in 2003.¹

Director Independence Requirements and Disclosures

The NYSE is proposing several changes with respect to determinations of director independence and related disclosures.

For purposes of the determination of whether a director is independent:

- the term “immediate family member” would not include step-children that do not share a step-parent’s home, or the in-laws of such step-children; and
- the terms “listed company” and “company” would each include any parent or subsidiary that would be required under U.S. GAAP to be in a consolidated group with the company.

The NYSE determined that the disclosure provided by some listed companies during 2005 was not sufficient to allow investors to adequately assess the quality of the board’s independence determination, and the proposed amendments would increase necessary disclosures. The NYSE believes that many companies were incorrectly using the bright line tests in the corporate governance rules as the sole criteria in determining whether or not a director is independent. The proposed changes to the disclosure rules would require, with respect to each independent director:

- disclosure either that the director has no relationships with the listed company (other than being a director and/or shareholder of the listed company) or has only immaterial relationships with the listed company; and
- if an immaterial relationship exists, a specific description of the relationship, as well as the basis for the board’s determination that such relationship does not preclude an independence determination; in lieu of discussing specific immaterial relationships, a board may determine that certain relationships are categorically immaterial if it discloses the types of relationships it has determined as such. Note, however, that any relationship required to be disclosed pursuant to Item 404 of SEC Regulation S-K cannot be deemed categorically immaterial.

¹ File No. SR-NYSE-2005-81. A copy of the proposed amendments is available at <http://www.nyse.com/pdfs/NYSE-2005-81.pdf>.

CEO Certifications and Officer Notifications

The NYSE proposes the following changes:

- The elimination of the requirement that listed companies disclose in their annual reports to shareholders, or if they do not prepare such annual reports, in their annual reports on Form 10-K, whether they have filed the CEO certifications required by the NYSE and any certifications required by the SEC.
- Listed companies would be required to notify the NYSE in writing after any executive officer becomes aware of *any* non-compliance with Section 303A, not just “material” non-compliance, as provided by the current rules.

Meetings of Non-Management Directors

The NYSE proposals clarify that meetings limited to independent directors only would satisfy the current requirements that companies hold regular meetings of non-management directors (which may include non-independent, non-management directors) and at least one meeting of independent directors only annually.

Audit Committee Duties and Disclosure Requirements

The NYSE proposals would require that if a company is relying on certain exceptions from SEC Rule 10A-3 in establishing that its audit committee meets specified requirements, the company must disclose such reliance and assess whether such reliance would materially adversely effect the ability of the audit committee to act independently and to satisfy the other requirements of Rule 10A-3.

A listed company is subject to the requirement that its audit committee meet to review and discuss the company’s financial statements and Management’s Discussion and Analysis disclosures. Closed-end mutual funds are not required to include MD&A disclosure; however, the NYSE proposals would require the audit committee of a closed-end mutual fund that *voluntarily* includes a “Management’s Discussion of Fund Performance” in its Form N-CSR to meet to review and discuss it.

Under the NYSE proposals, telephonic conference calls constitute meetings if allowed by applicable corporate law, but director polling is not allowed in lieu of meetings.

Code of Business Conduct and Ethics

Currently, the NYSE requires prompt disclosure of any waiver of the code of business conduct and ethics for executive officers or directors, which has been interpreted to mean within two or three business days of the board’s determination, but does not specify the method of disclosure. The proposed amendments would require listed companies to disclose to shareholders any waiver of the code of business conduct and ethics granted to executive officers and directors by press release, website disclosure, or by filing a current report on Form 8-K with the SEC, within four business days of such determination by the board, consistent with the 8-K filing deadline.

Disclosure and Websites

The NYSE proposals would:

- consolidate into one provision the requirement that certain disclosures be made in the listed company’s annual proxy statement, or, if the company does not file an annual proxy statement, in

the company's annual report filed with the SEC, and specify that the required disclosure cannot be summarized or incorporated by reference into such statements or reports from another document; and

- require a listed company to maintain a website and to post on the website charters for nominating/corporate governance committees, compensation committees, and audit committees, as well as corporate governance guidelines and codes of business conduct and ethics, and eliminate the current requirement that a listed company must state in its annual proxy statement, or, if the company does not file an annual proxy statement, in the company's annual report, that such documents are available on its website and available in print to any shareholder upon request.

Controlled Companies and Changes in Status

The NYSE proposals would clarify that, for purposes of Section 303A, a listed company may be deemed a controlled company only if more than 50% of the voting power for the election of directors is held by an individual, a group or another company.

The NYSE proposals also include provisions addressing the requirements and transition periods applicable to companies:

- whose status changes from foreign private issuer to U.S. company,
- that cease to be controlled companies; and
- that list upon emergence from bankruptcy.

Companies Listing in Conjunction with an Initial Public Offering

Currently, companies listing in conjunction with an IPO are able to phase in their independent audit, nominating and compensation committees, but are required under Section 303A to have at least one independent director on each committee as of the date of listing. Recognizing that market practice is to delay appointment of independent directors until the IPO's closing date to avoid prospectus liability concerns, the NYSE proposes:

- revising the IPO phase-in requirement to allow IPO companies until the earlier of the date of closing of the IPO or five business days from the date that trading on the NYSE commences to be in compliance with the requirements of Section 303A; and
- allowing companies that are listing in conjunction with a spin-off or carve-out transaction until the date of effectiveness of the transaction to be in compliance with the requirements of Section 303A.

The NYSE corporate governance rules require a company to have three directors on the audit committee as of the date of listing. As a result, companies may be forced to appoint non-independent directors to the audit committee in order to satisfy the three-person minimum. The NYSE proposes to amend Section 303A to clarify that companies that list in connection with an IPO who choose to phase in their independent audit committee members may phase in compliance with the three-person minimum on the same schedule; in the alternative, they may choose to have non-independent directors on the audit committee during the independent director phase-in period.

SEC Rule 10A-3 on audit committees, which is incorporated into the NYSE rules, provides that a company is listing "in conjunction with an IPO" only to the extent that, immediately prior to the effective date of the registration statement relating to the IPO, the company is not "required to file"

periodic reports with the SEC under the Securities Exchange Act of 1934 (the “Exchange Act”). The SEC has clarified that a company that is *voluntarily* filing reports under the Exchange Act at the time it lists would not be considered to be listing in conjunction with an IPO for purposes of Rule 10A-3. The NYSE proposes to reflect the SEC’s interpretation in the NYSE corporate governance rules and to clarify that previously reporting companies that list in connection with an IPO of equity securities may phase in compliance with the three-person minimum requirement for audit committees on the same basis as previously non-reporting companies, but may not include non-independent directors on the audit committee at any time.

Foreign Private Issuers

The proposed amendments would require foreign private issuers to disclose on their websites the significant differences between the corporate governance practices followed by the company in its home country and the requirements of Section 303A. Currently, companies have a choice of whether to make such disclosures in their websites or annual reports to shareholders.

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The NYSE proposals are subject to the SEC publication and comment process and must be approved by the SEC before becoming effective.

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For Additional Information

This client alert can be found, together with other recent Chadbourne & Parke LLP client alerts, on our website at www.chadbourne.com/publications/. Our client alerts are for general informational purposes and should not be regarded as legal advice. If you have any questions regarding the proposed amendments to the NYSE corporate governance rules, please contact any of the following:

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