

# Client Alert: NYSE and Nasdaq File Proposed Rule Changes on Shareholder Approval of Equity Compensation Plans

## A. Introduction

On October 7, 2002, the New York Stock Exchange filed with the Securities and Exchange Commission proposed new corporate governance rules relating to shareholder approval of equity compensation plans and the voting of proxies. The rules were originally included with the amended listing standards the NYSE filed with the SEC on August 16, 2002 (see August 2002 Client Alert).<sup>1</sup> On October 9 and 10, 2002 Nasdaq filed a similar proposal with respect to shareholder approval of equity compensation plans. Following a short public comment period, the NYSE and Nasdaq proposed rules will become effective immediately upon SEC approval.

## B. Shareholder Approval of Equity Compensation Plans

Under both the NYSE and Nasdaq proposals, with certain exceptions, all equity compensation plans, as well as “material revisions” to the terms of such plans, must be approved by the issuer’s shareholders. Certain equity compensation plans are specifically exempt from the shareholder approval requirement. These include:

- employment inducement awards (*i.e.*, grants of options or shares that serve as a material inducement to a person’s acceptance of employment);
- plans relating to mergers or acquisitions (*e.g.*, adjustments to outstanding equity compensation awards and certain plans assumed in a transaction);<sup>2</sup> and
- tax qualified plans (*e.g.*, savings plans and employee stock purchase plans) and parallel nonqualified plans (*i.e.*, excess benefit plans).

Any equity compensation plan that is not subject to shareholder approval must be approved by the company’s compensation committee or a majority of independent

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<sup>1</sup> The SEC requested that NYSE file its proposed rules related to shareholder approval of equity compensation plans and the voting of proxies separately from its other proposals in order to expedite review of these new rules.

<sup>2</sup> Subject to certain restrictions on the use of plans acquired in a merger or acquisition and conditions to be satisfied in order to make use of this exemption.

directors.<sup>3</sup> The Nasdaq proposal also requires notification to Nasdaq no later than 15 days prior to establishing or altering any equity compensation plan adopted without shareholder approval.

The new rules effectively eliminate the following prior exceptions to shareholder approval requirements for equity compensation plans :

- the NYSE treasury stock exception (which allowed for the use of equity compensation plans using only treasury shares without obtaining shareholder approval);
- the Nasdaq *de minimis* exception (which allowed for the use of equity compensation plans involving a *de minimis* number of shares without obtaining shareholder approval); and
- the NYSE and Nasdaq broadly based plan exception (which allowed for the use of certain plans generally available to a large number of employees without obtaining shareholder approval).

Material revisions. Material revisions to equity compensation plans must also be approved by shareholders. Some examples of “material revisions” are revisions that:

- materially increase the number of shares available under the plan (other than increases solely to reflect a reorganization, stock split, merger, spin-off or similar transaction);<sup>4</sup>
- change the types of awards available under the plan;
- materially expand the class of persons eligible to participate in the plan;
- materially extend the term of the plan; or
- materially change the method of determining the strike price of options under the plan.<sup>5</sup>

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<sup>3</sup> The Nasdaq proposal would not require this approval for plans relating to mergers and acquisitions.

<sup>4</sup> The NYSE proposal states that automatic increases in the number of shares available pursuant to an “evergreen” formula will not be considered a revision if the term of the plan is limited to a period not longer than 10 years. However, an existing plan adopted before the effective date of the NYSE proposal that contains an evergreen formula and that was not approved by shareholders must be submitted to shareholders for approval before the next increase in the number of shares pursuant to the evergreen provision.

<sup>5</sup> Nasdaq differs from NYSE in its definition of “material revisions.” Nasdaq currently determines the existence of a material amendment consistent with the SEC’s position under former Rule 16b-3 of the Exchange Act and, in particular, refers to the first three of the examples listed above as among the factors it would consider in determining whether a material amendment exists.

The NYSE proposal makes clear that a change in the method of determining “fair market value” from the closing price on the date of grant to the average price on the date of grant would not be deemed a material revision.

Repricing. The NYSE proposal states that, if a plan prohibits repricing of options, any revision that deletes or limits the scope of that provision will be deemed a material revision. If a plan does not specifically permit repricing of options, the plan will be deemed to prohibit them and any actual repricing of options will be considered a material revision to the terms of the plan, even if the plan itself is not revised.<sup>6</sup>

Grandfathering. Any existing equity compensation plan in place at the effective date will not be subject to the new NYSE or Nasdaq shareholder approval requirements unless there is a material revision to the plan.

Applicability to foreign private issuers. Although neither the NYSE nor Nasdaq provides a blanket exemption for foreign private issuers, the NYSE proposal states that the shareholder approval requirement will not apply to a NYSE-listed foreign private issuer, assuming the issuer has provided the NYSE with the required NYSE home country practice certification. Representatives of Nasdaq also have confirmed that Nasdaq’s existing procedures by which foreign private issuers may apply for exemptions from compliance with the corporate governance requirements will apply to the proposed shareholder approval requirements, subject to the additional disclosure requirements for issuers who obtain such an exemption.

### C. Voting of Proxies

The NYSE proposal would preclude brokers from voting on equity compensation plans presented to shareholders without instructions from the beneficial owners. This proposal applies to NYSE-member brokers and, as such, will affect all public companies and may require significantly greater efforts in the solicitation of shareholder votes on equity compensation plans. The NYSE intends to establish a working group to advise on possible mechanisms to facilitate implementation of this proposal, but the proposal will become effective immediately upon SEC approval.

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<sup>6</sup> For these purposes, a “repricing” means: (i) any amendment to the terms of an option after it is granted to lower its strike price, (ii) any action treated as a repricing under GAAP and (iii) any cancellation of an option at a time when its strike price is equal to or less than the fair market value of the underlying stock, in exchange for another option, restricted stock, or other equity, unless the cancellation and exchange occurs in connection with a merger, acquisition, spin-off or similar transaction (regardless of whether the option, restricted stock or other equity is delivered simultaneously with the cancellation, treated as a repricing under GAAP or voluntary on the part of the option holder).

The SEC requests that comments on the NYSE proposal be received no later than October 29, 2002 and comments on the Nasdaq proposal be received no later than November 2, 2002. Comments may be submitted electronically to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to either File No. SR-NYSE-2002-46 for the NYSE proposed rules or File No. SR-NASD-2002-140 for the Nasdaq proposed rules (in the subject line if sent electronically).

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#### For Additional Information

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