

Corporate and Securities Law Developments **NEWSLETTER**

JUNE 20, 2002

CORPORATE GOVERNANCE REFORM: PROPOSED CHANGES TO NYSE AND NASDAQ LISTING STANDARDS

In an effort to bolster investor confidence in the integrity and accountability of issuers, the New York Stock Exchange and Nasdaq recently proposed new listing requirements intended to strengthen corporate governance and disclosure standards for listed companies.¹ The impetus for reform came from Securities and Exchange Commission Chairman Harvey Pitt who, in the wake of the Enron collapse and other recent high profile failures of corporate controls, urged the NYSE and Nasdaq to review and improve existing listing requirements that relate to corporate governance.² The proposed changes are part of an ongoing effort by regulators and key players in the business community to restore public trust in the markets, publicly traded companies and the regulatory system through corporate governance reform.

The NYSE and Nasdaq proposals incorporate many of the recommendations articulated in recent weeks by business leaders such as The Business Roundtable, an association of the Chief Executive Officers of leading American companies,³ and Henry Paulson, the Chief Executive Officer of The Goldman Sachs Group.⁴ The Conference Board, an organization of many well-known businesses, recently announced plans to create a commission which will offer guidelines on corporate governance issues.⁵ The reforms proposed by these business leaders include (i) increasing the role and authority of “independent directors”, (ii) tightening the definition of “independent director”, (iii) requiring stockholder approval of compensation plans for directors and executive officers, (iv) requiring public disclosure by companies of their corporate governance

¹ See *NYSE Board Releases Report of Corporate Accountability and Listing Standards Committee* (June 6, 2002), available at <http://www.nyse.com/press/press.html>; *Nasdaq Submits First Round of Corporate Governance Rule Changes to the SEC; Announces Plan for Additional Issues for Review This Month* (June 5, 2002), available at <http://www.nasdaqnews.com>; *Nasdaq Approves Rule Changes to Modify Key Corporate Governance Standards* (May 24, 2002), available at <http://www.nasdaqnews.com>.

² See *Pitt seeks Review of Corporate Governance, Conduct Codes* (February 13, 2002), available at <http://www.sec.gov/news/press/2002-23.txt>.

³ The Business Roundtable published a white paper in May 2002 proposing best practices for corporate governance. See *The Business Roundtable, Principles of Corporate Governance* (May 14, 2002), available at <http://www.brtable.org/document.cfm/704>.

⁴ See Henry M. Paulson, *Restoring Investor Confidence: An Agenda For Change* (June 5, 2002), available at <http://www.goldmansachs.com/news/docs/restoring-investor-confidence.pdf>.

⁵ See *Blue-Ribbon Governance Commission To Be Announced*, (July 19, 2002), available at <http://www.conference-board.org/search/dpress.cfm?pressid+1121>.

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procedures and (v) aligning executive compensation to long-term interests of shareholders.

The chart below compares NYSE’s and Nasdaq’s proposed changes. The NYSE proposals were outlined in a Report of the Committee on Corporate Accountability and Listing Standards and the NYSE board plans to consider formal rule changes addressing the Committee’s recommendations on August 1, 2002. Nasdaq’s board has adopted its first round of rule modifications and filed them with the SEC on June 6, 2002. Additional Nasdaq proposals are expected later this month.⁶ The final form of NYSE’s and Nasdaq’s proposed rule modifications will be subject to the SEC’s approval after a notice and comment period.

If you would like additional information on the NYSE or Nasdaq proposals, or on the other recommendations of various business leaders, please contact:

Dick Cass DCass@Wilmer.com
(202) 663-6503

Russ Bruemmer RBruemmer@Wilmer.com
(202) 663-6804

Meredith Cross MCross@Wilmer.com
(202) 663-6644

Roger Patterson RPatterson@Wilmer.com
(202) 663-6246

⁶ The full text of the second round of proposals is not yet available; expected proposals are identified as such in the chart below.

CHART COMPARING PROPOSED NYSE AND NASDAQ CORPORATE GOVERNANCE LISTING STANDARDS

	NYSE	NASDAQ
Board Independence	Independent directors must comprise a majority of a company’s board within two years of rule’s enactment. Currently there only must be enough independent directors to have an audit committee with three independent directors.	Expected to propose that independent directors must comprise a majority of a company’s board. Currently companies must have at least two independent directors on their board and an audit committee of at least three members, all but one of which must be independent.
Definition of “Independent Director”	Board must affirmatively determine that a director has no material relationship with the listed company. Companies must disclose these determinations. “Cooling-off” period for director independence is extended from three-years to five-years for former employees. Requirement is expanded to include employment with former or present auditor or with any company whose compensation committee includes an officer of the listed company. Directors with immediate family members in foregoing categories are also subject to “cooling-off” period.	Prohibits <u>any</u> payments (including compensation and political contributions, but excluding compensation for services as a director) during the current or previous year in excess of \$60,000 to a director. Rule expanded to include payments to director’s immediate family members. Limits corporate donations to charities where director serves as an executive officer. Rule change effective when currently listed issuers file next proxy statement electing directors.
Director Meetings	Non-management directors required to meet without management in regular executive sessions. Audit committee should meet separately, at least quarterly, with management, internal auditors and independent auditors.	No new requirement.
Committees	Compensation committee to be comprised solely of independent directors. Companies required to create a corporate governance (nominating) committee, comprised solely of independent directors, with a written charter.	Expected to propose that compensation committee to be comprised solely of independent directors.

	NYSE	NASDAQ
Corporate Governance Guidelines	<p>Companies required to adopt and publish corporate governance guidelines including a code of business conduct and ethics and key committee charters.</p> <p>Company must promptly disclose waivers of ethics code involving directors or executive officers.</p> <p>Annual performance evaluations of the entire board and corporate governance, compensation, and audit committees.</p>	<p>Expected to require increased use of corporate codes of conduct and compliance methods to support them.</p>
Audit Committee	<p>Expands scope of audit committee's authority and responsibilities.</p> <p>Audit committee to: (i) ensure the outside auditor's independence, (ii) review all relationships between the outside auditor and the company, and (iii) have sole responsibility for hiring and firing company's auditors, and for approving any significant non-audit work by the auditors.</p> <p>In addition to being financially literate, the chair of the audit committee must have accounting or financial management experience.</p> <p>Compensation of an audit committee member is limited to director's fees.</p> <p>An audit committee member associated with a major shareholder may not vote in audit committee proceedings.</p> <p>Broadens audit committee charter requirements.</p>	<p>Expected to expand scope of the audit committee's authority.</p> <p>Audit committee or a comparable body of the board of directors must not only review, but also approve, all related-party transactions.</p> <p>Expected to propose a "cooling-off" period during which former auditors would be precluded from serving on the audit committee.</p>
Stock Option Plans	<p>Shareholder approval required for all equity-based compensation plans.</p> <p>Brokers may only vote customer shares on plans pursuant to customer instructions.</p>	<p>Shareholder approval required for all stock options plans in which officers or directors participate except for:</p> <ul style="list-style-type: none"> • inducement grants to new executive officers if approved by an independent compensation committee or a majority of the company's independent directors; and • ESOP's and warrants and rights offered generally to all shareholders.
Sanctions	<p>NYSE may issue a public reprimand letter for violation of Exchange rules and ultimately suspend or de-list an offending company.</p> <p>Proposals urge Congress to give the SEC authority to permanently bar officers and directors from holding office again after violating their duties to shareholders.</p>	<p>An issuer who (i) intentionally fails to provide Nasdaq with requested documentation or information or (ii) provides communications containing material misrepresentations or omissions may be delisted.</p>
Foreign Issuers	<p>Listed foreign issuers to disclose any significant ways in which their corporate governance practices differ from NYSE listing rules.</p>	<p>Expected to require listed foreign issuers to disclose if they have received SEC waivers of corporate governance standards.</p>

	NYSE	NASDAQ
CEO Annual Certifications*	<p>CEO's will be required to make several certifications annually:</p> <ul style="list-style-type: none"> that procedures established to ensure investors receive accurate and complete information are being followed, that he or she has reviewed those procedures with the board and has no reasonable cause to believe that the information provided is not accurate and complete, and that they are not aware of any company violations of NYSE rules. 	No new requirements.
Board Education and Evaluation	<p>Encourages every listed company to establish an orientation program for new board members.</p> <p>NYSE to develop a Directors Institute.</p> <p>Companies to annually evaluate the performance of the board and committees.</p>	Expected to propose strengthening of continuing education programs for directors.
Auditors and Disclosure	Proposals urge the SEC to prohibit relationships between auditors and their clients that would affect the fairness and objectivity of audits.	<p>Companies must disclose receipt of an audit opinion with a going concern qualification through a press release and provide text to Nasdaq prior to announcement.</p> <p>Disclosure of material information will be harmonized with Regulation F-D.</p>

* The SEC is also proposing new rules to require officer certifications on SEC filings. See *SEC Proposes Requiring Certification of Quarterly and Annual Reports* (June 12, 2002), available at <http://www.sec.gov/news/press/2002-88.htm>.

WCP Corporate and Securities Practice Group Partners

Jorge E. Alers	Stuart F. Delery	Satish Kini	Kurt L. Schmoke
James E. Anderson	Mark A. Dewire	Michael R. Klein	Klaus Schubert
Philip D. Anker	Colleen Doherty-Minicozzi	Alexander Kollmorgen	Mark S. Shelton
Robert G. Bagnall	Stephen P. Doyle	Yoon-Young Lee	Marianne K. Smythe
Brandon Becker	Jennifer M. Drogula	Lewis Liman	Roland Steinmeyer
Joseph K. Brenner	Van W. Ellis	Martin E. Lybecker	Peter K. Vigeland
Russell J. Bruemmer	Paul Engelmayer	Eric R. Markus	Andrew N. Vollmer
J. Beckwith Burr	Gregory J. Ewald	Robert B. McCaw	Paul A. von Hehn
Mark D. Cahn	Simon Firth	William McLucas	John B. Watkins
Richard W. Cass	Andrew N. Goldman	Thomas E. D. Millspough	Harry J. Weiss
Georg Graf Zu Castell-Castell	C. Thomas Hicks III	Duane D. Morse	Andrew B. Weissman
Gregorio B. Cater	Michael R. Holter	William J. Perlstein	Thomas W. White
Louis R. Cohen	Robert F. Hoyt	Mark Pollak	William A. Wilson III
Bruce E. Coolidge	Andrew Kaizer	Erika L. Robinson	Soo J. Yim
Meredith Cross	Glynn D. Key	Frank E. Roitzsch	
Charles E. Davidow	R. Scott Kilgore	John W. Ryan	

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2445 M Street, N.W. Washington, D.C. 20037-1420 Telephone: (202) 663-6000	520 Madison Avenue New York, NY 10022 Telephone: (212) 230-8800	100 Light Street Baltimore, MD 21202 Telephone: (410) 986-2800	1600 Tysons Boulevard Tysons Corner, VA 22102-4826 Telephone: (703) 251-9700	4 Carlton Gardens London SW1Y5AA Telephone: 011 (44207) 872-1000	Rue de la Loi 15 Wetstraat B-1040 Brussels Telephone: 011 (322) 285-4900	Friedrichstrasse 95 D-10117 Berlin Telephone: 011 (49-30) 2022-6400
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