



WILMER, CUTLER & PICKERING

Corporate and Securities Law Developments NEWSLETTER

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New NYSE and Nasdaq Corporate Governance Listing Standards

On November 4, 2003, the Securities and Exchange Commission approved changes to the listing standards of the New York Stock Exchange and the Nasdaq Stock Market that impose significant new corporate governance requirements on listed companies.¹

I. History

The NYSE and the National Association of Securities Dealers have proposed changes to their listing standards, particularly in the area of corporate governance, as a result of a series of events in recent years. In 1999, the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees issued a report and recommended changes to improve the effectiveness of audit committees of listed companies. The NYSE and NASD revised their listing standards related to audit committees. In February 2002, after a spate of corporate failures, Harvey Pitt, then-Chairman of the SEC, requested that the NYSE and NASD review their listing standards with an emphasis on corporate governance. In response, the NYSE and NASD, through Nasdaq, filed corporate governance reform proposals.

In January 2003, pursuant to the Sarbanes-Oxley Act of 2002, the SEC proposed Rule 10A-3 under the Securities Exchange Act of 1934, as amended, which directs each national securities exchange and national securities association to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements specified in Rule 10A-3. Because their corporate governance reform proposals did not comply with proposed Rule 10A-3, the NYSE and Nasdaq revised their proposals. After the SEC adopted Rule 10A-3, the NYSE and Nasdaq filed further amendments to their proposals to conform to the requirements of the final Rule 10A-3 and to address other concerns raised by the SEC.

Significant provisions of the final NYSE and Nasdaq listing standards are described below.

II. New NYSE Listing Standards

A. Independent Directors

All NYSE-listed companies must have a majority of independent directors on their boards.² A director is deemed independent only if the board

¹ SEC Release No. 34-48745.

² Section 303A(1) of the NYSE Listed Company Manual ("NYSE Manual"). Exemptions for controlled companies, limited partnerships and certain other companies are described below in Section II.K.

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affirmatively determines that the director has no material relationship with the company, or any parent or subsidiary in a consolidated group with the company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company.³ Material relationships may include commercial, industrial, banking, legal, accounting, charitable or familial relationships. Independence is determined based on considerations of a director's independence from management; therefore, significant stock ownership alone will not preclude a board finding of independence.

Disclosures. If a board determines that a director's relationship with the company is not material, the company must disclose the basis for such determination in its annual proxy statement or, if the company does not file an annual proxy statement, in its annual report on Form 10-K. A board may adopt categorical standards to assist in making independence determinations, and, if it does, it must disclose such standards. If a director satisfies such standards, the company may make a general disclosure regarding such director's independence. If a director does not satisfy such standards and the board nevertheless determines that such director is independent, the company must provide a specific explanation regarding such director's independence.

Independence Disqualifications. In addition to requiring the board to determine affirmatively a director's independence, the NYSE established certain bright-line independence disqualifications. A director is not independent if:

- the director is or has been an employee of the company or an immediate family

member⁴ of the director is or has been an executive officer of the company, until three years after the end of such employment relationship;⁵

- the director or an immediate family member of the director has received more than \$100,000 in direct compensation from the company other than director and committee fees or certain forms of deferred compensation for prior service that is not contingent on continued service, until three years after he or she stops receiving compensation;⁶
- the director is or has been affiliated with or employed by, or an immediate family member of the director is or has been affiliated with or employed in a professional capacity by, the company's present or former internal or external auditor, until three years after the affiliation, employment relationship or auditing relationship ends;
- the director or an immediate family member of the director is or has been employed as an executive officer of another company whose compensation committee includes an executive officer of the listed company, until three years after the service or employment ends; or
- the director is or has been an executive officer of or is employed by, or an immediate family member of the director is or has been an executive officer of, a company that makes payments to, or receives payments from, the listed company for property or

³ Section 303A(2)(a) of the NYSE Manual.

⁴ An "immediate family member" includes a director's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law and anyone (other than domestic employees) who shares such director's home. A person ceases to be an immediate family member upon legal separation or divorce, death or incapacity.

⁵ Employment as an interim Chairman or CEO does not disqualify a director from being considered independent following such employment.

⁶ Compensation received by a director for former service as an interim Chairman or CEO and compensation received by an immediate family member for service as a non-executive employee of the company do not count toward the \$100,000 limit.

services in an amount which, in any single fiscal year, exceeds the greater of \$1 million, or 2% of such other company's consolidated gross revenues, until three years after the threshold is reached.⁷

Look-Back Period. The disqualifying relationships described above preclude a board determination of director independence if the relationships exist as of the date of the independence determination or during a "look-back" period measured from the independence determination date. The look-back period will be phased in. Until November 4, 2004, the look-back period is one year. Beginning on November 4, 2004, the look-back period will be three years. Because of the phase-in, it is possible that a director may be deemed independent during the first year following the adoption of the listing standards but may be disqualified for the remainder of the phase-in period. For example, a director who has a disqualifying relationship that existed from one to two years prior to the adoption of the standards will be able to serve as an independent director until November 4, 2004, but would be disqualified thereafter until the third anniversary of the disqualifying relationship.

B. Executive Sessions

Non-management directors must meet at regularly scheduled executive sessions without management. "Non-management" directors are directors who are not company officers, as defined in Rule 16a-1(f) under the Securities Exchange Act of 1934. If the group of non-management directors includes directors who are not independent by virtue of a material relationship, former status or family membership or for any other reason, then

the company should at least once a year schedule an executive session including only independent directors.

If one director is selected to preside at the executive sessions, such director's name must be disclosed in the annual proxy statement or, if the company does not file an annual proxy statement, in the annual report on Form 10-K. Alternatively, the company may disclose the procedure by which a presiding director is selected for each executive session (for example, by rotation).

Companies must disclose a method for interested parties to communicate directly with the presiding director or with the non-management directors as a group. Companies may use for this purpose the same procedures established to comply with the requirement that audit committees establish procedures to handle complaints and anonymous employee submissions regarding accounting or auditing matters, described below in Section II.E.

C. Nominating/Corporate Governance Committee

Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.⁸ The nominating/corporate governance committee must have a written charter that addresses the nominating/corporate governance committee's purpose and responsibilities and an annual performance evaluation of the nominating/corporate governance committee. The charter also should address committee member qualifications, committee member appointment and removal, committee structure and operations

⁷ Section 303A(2)(b) of the NYSE Manual. The payments and the consolidated gross revenues to be measured are those reported in the last completed fiscal year. The look-back provision applies only to the director's or immediate family member's current employer.

A charitable organization is not considered a company for purposes of this test. However, if the listed company makes contributions to a charitable organization in which a director serves as an executive officer and such contributions exceeded the greater of \$1 million or 2% of such charitable organization's consolidated gross revenues, then the company must disclose such contributions in its annual proxy statement, or if the company does not file an annual proxy statement, in its Form 10-K. In addition, in evaluating a director's independence generally under Section 303A(2)(a), the company must consider donations to a charitable organization for which a director serves as an executive officer.

⁸ Section 303A(4) of the NYSE Manual.

(including authority to delegate to subcommittees) and committee reporting to the board. In addition, the charter should give the nominating/corporate governance committee sole authority to retain and terminate any search firm that is used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.

The responsibilities of the nominating/corporate governance committee are as follows:

- identify individuals qualified to become board members, consistent with criteria approved by the board;
- select, or recommend that the board select, director nominees for the next annual meeting of shareholders;⁹
- develop and recommend to the board a set of corporate governance principles applicable to the corporation; and
- oversee the evaluation of the board and management.

The board may delegate the responsibilities of the nominating/corporate governance committee to another committee provided that such other committee is composed entirely of independent directors and has a written charter.

D. Compensation Committee

Listed companies must have a compensation committee composed entirely of independent directors.¹⁰ The compensation committee must have a written charter that addresses the compensation committee's purpose and responsibilities and an annual performance evaluation of the compensation committee. The charter also should address

committee member qualifications, committee member appointment and removal, committee structure and operations (including authority to delegate to subcommittees) and committee reporting to the board.

The responsibilities of the compensation committee are as follows:

- review and approve corporate goals and objectives relevant to CEO compensation;
- evaluate the CEO's performance based on the foregoing goals and objectives;
- determine and approve the CEO's compensation level based on the foregoing evaluation, either as a committee or together with the other independent directors (as directed by the board);
- make recommendations to the board with respect to non-CEO compensation, incentive-compensation plans and equity-based plans; and
- produce a compensation committee report on executive compensation as required by the SEC to be included in the company's annual proxy statement or annual report on Form 10-K.

Even though the compensation committee, alone or with other independent directors, determines the CEO compensation, discussion of CEO compensation with the board is not precluded. In addition, the board may delegate the responsibilities of the compensation committee to another committee provided that such other committee is composed entirely of independent directors and has a written charter.

⁹ If a company is legally required by contract or otherwise to provide third parties with the ability to nominate directors (for example, preferred stock rights to elect directors upon a dividend default, shareholder agreements and management agreements), the selection and nomination of such directors need not be subject to the nominating committee process.

¹⁰ Section 303A(5) of the NYSE Manual.

E. Audit Committee

Composition. Listed companies must have an audit committee of at least three members, all of whom must be independent.¹¹ Audit committee members must satisfy the independence standards for directors described above in Section II.A as well as the dual independence requirements for audit committee members set forth in Rule 10A-3.¹² First, under Rule 10A-3, an audit committee member may not accept, directly or indirectly, any consulting, advisory or other compensatory fee from the company or any of its subsidiaries, other than (1) compensation for board or committee service or (2) fixed amounts of compensation under a retirement plan for prior service that is not contingent on future service. Second, an audit committee member may not be an “affiliated person” of the company or any of its subsidiaries.¹³

Each audit committee member must be financially literate, as such qualification is interpreted by the board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. At least one member must have accounting or related financial management expertise, as the board interprets such qualification in its business judgment. Although the new listing standards do not require that the audit committee include a member who satisfies the definition of audit committee financial expert as set forth in Item 401(e) of Regulation S-K, a board may presume that such a person has accounting or related financial management expertise.

If an audit committee member serves simultaneously on the audit committees of more than three public companies and the listed company does not limit the number of audit committees on which its audit committee members may serve, the listed company’s board must determine that such simultaneous service would not impair the ability of the audit committee member to effectively serve on the listed company’s audit committee. The company must disclose such determination in its annual proxy statement or, if the company does not file an annual proxy statement, in its annual report on Form 10-K.

Charter. An audit committee must have a written charter that addresses the following:

- the audit committee’s purpose, which, at a minimum, must be (1) to assist board oversight of (a) the integrity of the company’s financial statements, (b) the company’s compliance with legal and regulatory requirements, (c) the independent auditor’s qualifications and independence and (d) the performance of the company’s internal audit function and independent auditors; and (2) to prepare an audit committee report as required by the SEC to be included in the company’s annual proxy statement;
- an annual performance evaluation of the audit committee; and
- the duties and responsibilities of the audit committee, as described below.¹⁴

11 Sections 303A(6), 303A(7)(a) and 303A(7)(b) of the NYSE Manual.

12 A company may cure non-compliance with the independence requirements of Rule 10A-3 in the manner provided in Rule 10A-3(a)(3). If a member of the audit committee ceases to be independent for reasons outside the member’s reasonable control, the member may continue to serve on the audit committee until the earlier of its next annual meeting of shareholders or one year from the occurrence of the event that caused the member to no longer be independent. Companies must notify the NYSE of any event of non-compliance.

13 An “affiliated person” of the company is a person that directly, or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the company. Exchange Act Rule 10A-3(e)(1)(i). Under the safe harbor provision of Rule 10A-3, a person will be deemed not to be in control of the company if the person (1) is not the beneficial owner, directly or indirectly, of more than 10% of any class of voting equity securities of the company and (2) is not an executive officer of the company. Exchange Act Rule 10A-3(e)(1)(ii).

14 Section 303A(7)(c) of the NYSE Manual.

Responsibilities. Under Rule 10A-3, the audit committee has the following responsibilities:

- appoint, compensate, retain and provide oversight of the work of the independent auditor;
- establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters and procedures for the confidential, anonymous submission by company employees regarding questionable accounting or auditing matters;
- retain and compensate independent counsel and other advisers as the audit committee determines necessary to carry out its duties; and
- determine the appropriate level of funding to be provided by the company for payment of the independent auditor and outside advisers and administrative expenses incurred by the audit committee in carrying out its duties.¹⁵

The new listing standards impose the following additional requirements on the audit committee:

- obtain and review at least annually a report by the independent auditor describing the firm's internal quality-control procedures; any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues; and, in order to assess the auditor's independence, all relationships between the independent auditor and the company;

- evaluate, based on the foregoing report, the auditor's qualifications, performance and independence, including the lead partner of the independent auditor, taking into account the opinions of management and the company's internal auditors; consider whether there should be regular rotation of the audit firm; and present its findings with respect to the independent auditor to the full board;
- discuss the annual audited financial statements and quarterly financial statements with management and the independent auditor, including the company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations";
- discuss generally the company's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies (but not necessarily in advance of each earnings release or each instance in which the company may provide earnings guidance);
- discuss guidelines and policies with respect to risk assessment and risk management, including the company's major financial risk exposures and the steps management has taken to monitor and control such exposures;¹⁶
- meet separately and periodically with management, internal auditors (or other personnel responsible for the internal audit function) and independent auditors;
- review with the independent auditor any audit problems or difficulties and management's response, including any restrictions on the scope of the independent auditor's activities or on access to requested infor-

15 Exchange Act Rule 10A-3(b)(2), (3), (4) and (5).

16 If the company manages and assesses risk through mechanisms other than the audit committee, the audit committee should review generally the processes that the company has in place for such purpose.

mation and any significant disagreements with management;¹⁷

- set clear hiring policies for employees or former employees of the independent auditors;
- report regularly to the board of directors, including a review with the full board of any issues that arise with respect to the quality or integrity of the company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the independent auditor or the performance of the internal audit function; and
- review (1) major issues regarding accounting principles and financial statement presentations and major issues as to the adequacy of the company's internal controls and any special audit steps adopted in light of material control deficiencies; (2) analyses prepared by management and/or the independent auditor made in connection with the preparation of the financial statements; (3) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements; and (4) the type and presentation of information to be included in earnings press releases, as well as any financial information and earnings guidance provided to analysts and rating agencies.¹⁸

F. Internal Audit Function

Listed companies must maintain an internal audit function to provide management and the

audit committee with ongoing assessments of the company's risk management processes and system of internal control.¹⁹ A company may choose to outsource the internal audit function to a third party service provider other than its independent auditor.

G. Corporate Governance Guidelines

Listed companies are required to adopt and disclose corporate governance guidelines that address the following subjects:

- director qualification standards which, at a minimum, reflect the independence requirements described above in Section II.A and which may address other substantive qualification requirements, including policies limiting the number of boards on which a director may sit and director tenure, retirement and succession;
- director responsibilities, which clearly articulate what is expected from a director, including basic duties and responsibilities with respect to attendance at board meetings and advance review of meeting materials;
- director access to management and, as necessary and appropriate, independent advisors;
- director compensation, including general principles for determining the form and amount of director compensation;²⁰
- director orientation and continuing education;

¹⁷ Such review may include accounting adjustments that were noted or proposed by the auditor but were passed; any communications between the audit team and the audit firm's national office respecting auditing or accounting issues presented by the engagement; and any management or internal control letter issued, or proposed to be issued, by the audit firm to the company. Such review should include a discussion of the responsibilities, budget and staffing of the company's internal audit function.

¹⁸ Section 303A(7)(c)(iii) of the NYSE Manual.

¹⁹ Section 303A(7)(d) of the NYSE Manual.

²⁰ The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed what is customary. Similar concerns may be raised when the company makes substantial charitable contributions to organizations with which a director is affiliated, or enters into consulting contracts with (or provides other indirect forms of compensation to) a director. The board should critically evaluate each of these matters when determining the form and amount of director compensation and the independence of a director.

- management succession, including policies and principles for CEO selection and performance review, as well as policies regarding succession in the event of an emergency or the retirement of the CEO; and
- annual performance evaluation of the board to determine whether the board and its committees are functioning effectively.²¹

A company's website must include its corporate governance guidelines and the charters of its most important committees, including at least the audit committee and, if applicable, the compensation and nominating/corporate governance committees. In addition, a company's annual report on Form 10-K must state that the foregoing information is available on its website and is available in print to any shareholder who requests it.

H. Code of Business Conduct and Ethics

Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees and must promptly disclose any waiver of the code for directors or executive officers.²² A company may determine its own policies; however, the new listing standards suggest that the code of business conduct and ethics should address the most important topics, including the following:

- conflicts of interest, which occur when an individual's private interest interferes in any way, or even appears to interfere, with the interests of the company as a whole (the com-

pany should have a policy that prohibits such conflicts of interest and provides a means for employees, officers and directors to communicate potential conflicts to the company);²³

- corporate opportunities (employees, officers and directors owe a duty to the company to advance its legitimate interests when the opportunity to do so arises);²⁴
- confidentiality (employees, officers and directors should maintain the confidentiality of information entrusted to them by the company or its customers, except when disclosure is authorized or legally mandated);
- fair dealing (employees, officers and directors should endeavor to deal fairly with the company's customers, suppliers, competitors and employees and not take unfair advantage of anyone through manipulation, concealment, abuse of privileged information, misrepresentation of material facts or any other unfair-dealing practice);
- protection and proper use of company assets (employees, officers and directors should protect the company's assets and ensure their efficient use for legitimate business purposes);
- compliance with laws, rules and regulations (the company should proactively promote compliance with laws, rules and regulations, including insider trading laws); and

21 Section 303A(9) of the NYSE Manual.

22 Section 303A(10) of the NYSE Manual.

23 A conflict situation can arise when an employee, officer or director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when an employee, officer or director, or a member of his or her family, receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern.

24 Employees, officers and directors should be prohibited from (1) taking for themselves personally opportunities that are discovered through the use of corporate property, information or position; (2) using corporate property, information, or position for personal gain; and (3) competing with the company.

- encouragement of the reporting of any illegal or unethical behavior (the company should proactively promote ethical behavior; encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation; and ensure that employees know that the company will not allow retaliation for reports made in good faith).

A company's website must include its code of business conduct and ethics, and its annual report on Form 10-K must state that the foregoing information is available on its website and is available in print to any shareholder who requests it.

I. CEO Certification and Notification of Non-Compliance

CEOs of listed companies must certify to the NYSE each year that they are not aware of any violation by the company of the corporate governance listing standards.²⁵ Both the CEO certification to the NYSE, and any CEO/CFO certifications required to be filed with the SEC regarding the quality of the company's public disclosure, must be disclosed in the company's annual report to shareholders or, if the company does not prepare an annual report to shareholders, in the company's annual report on Form 10-K. A CEO must promptly notify the NYSE in writing after any executive officer becomes aware of any material non-compliance with any applicable provisions of the corporate governance listing standards.

J. Public Reprimand Letter

The NYSE may issue a public reprimand letter to any listed company that violates a listing standard.²⁶

K. Exceptions

The new listing standards apply to all companies with common equity securities listed on the NYSE with the following exceptions:²⁷

Controlled Companies, Limited Partnerships and Companies in Bankruptcy. Controlled companies (defined below), limited partnerships and companies in bankruptcy proceedings are exempt from the requirements that the board have a majority of independent directors and that the nominating/corporate governance committee and compensation committee be composed entirely of independent directors. A "controlled company" is a company of which more than 50% of the voting power is held by an individual, a group or another company.²⁸ A company relying on the controlled company exemption must disclose its reliance on the exemption, its status as a controlled company and the basis for its determination that it is a controlled company in its annual proxy statement or, if the company does not file an annual proxy statement, in its annual report on Form 10-K.

Closed-End and Open-End Management Companies. Closed-end and open-end management investment companies that are registered under the Investment Company Act of 1940 are exempt from all NYSE corporate governance listing standards except that such management investment companies must comply with (1) the audit committee requirements set forth above in Section II.E (except that audit committee members are not required to satisfy the independence requirements); and (2) the CEO certification and notification requirements described above in Section II.I. In light of the common practice of having the same directors serve on boards in the same fund complex, closed-end funds are not required to disclose board determinations regarding simultaneous service of audit committee members of

25 Section 303A(12) of the NYSE Manual.

26 Section 303A(13) of the NYSE Manual.

27 Section 303A(0) of the NYSE Manual.

28 *Id.*

the closed-end fund on the audit committees of more than three public companies. However, a board of a closed-end fund is required to make the determination that such simultaneous service would not impair the ability of such member to effectively serve on the fund's audit committee.

In addition to the audit committee requirements regarding complaints and submissions by employees of the listed company, audit committees of closed-end and open-end funds are required to establish procedures for the confidential and anonymous submission by employees of the investment adviser, administrator, principal underwriter or any other provider of accounting related services for the management company, as well as employees of the management company. This responsibility must be addressed in the audit committee charter.

Other Companies. There are additional exceptions for business development companies, companies listing only preferred or debt securities and certain passive business organizations, as set forth in the listing standards.

L. Foreign Private Issuers

Foreign private issuers are permitted to follow home country practice in lieu of the corporate governance listing standards provided that (1) such foreign private issuers have an audit committee that satisfies the requirements of Rule 10A-3; (2) such foreign private issuers disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies under the listing standards; and (3) the CEO of any such foreign private issuer promptly notifies the NYSE in writing after any executive officer becomes aware of any ma-

terial non-compliance with any applicable provisions of the corporate governance listing standards.²⁹

M. Effective Dates

Listed companies generally are required to comply with the corporate governance listing standards by the earlier of their first annual meeting after January 15, 2004, or October 31, 2004.³⁰ However, if a company with a classified board is required to change a director who would not normally stand for election in such annual meeting, the director may continue in office until the second annual meeting after such date, but no later than December 31, 2005. Notwithstanding the foregoing, foreign private issuers have until July 31, 2005 to comply with the audit committee requirements.

Companies listing in conjunction with their initial public offering are required to have one independent audit committee member at the time of listing, a majority of independent audit committee members within 90 days of listing and fully independent committees within one year of listing. Such companies must meet the majority of independent directors requirement within 12 months of listing.

Companies that are emerging from bankruptcy or that have ceased to be controlled companies, as defined in the listing standards, may phase in the requirements to have independent compensation and nominating/corporate governance committees and majority independent boards on the same schedule as companies listing in conjunction with an initial public offering.

Companies that transfer from another market to the NYSE have 12 months from the date of transfer

29 *Id.*

30 Companies are not required to include the new required disclosures in documents filed with the SEC before the effective date. However, companies may want to consider including such disclosures before the effective date to assure shareholders and proxy advice services of compliance with the new listing standards. In addition, the NYSE likely will be reviewing the upcoming proxy statements to determine whether companies were in compliance as of their annual meeting dates. Companies may be able to reduce future inquiries by NYSE staff by including the disclosures in the proxy statements.

In a recent communication to listed companies, the NYSE clarified the transition dates for the new listing standards and notified companies that they would be requested to confirm compliance with Section 303A of the NYSE Manual approximately 30 days after their shareholder meetings.

to comply with any requirement to the extent the market on which they were listed did not have the same requirement. If the former market has a substantially similar requirement and the company has an unexpired transition period with respect to such requirement, the transferring company may rely on the unexpired transition period from the former market.

III. New Nasdaq Listing Standards

A. Independent Directors

All Nasdaq-listed companies must have a majority of independent directors on their boards.³¹ A company must make an affirmative determination that individuals serving as independent directors do not have a relationship that would impair their independence. A company also must disclose those directors that the board has determined to be independent in its annual proxy statement or, if the company does not file an annual proxy statement, in its annual report on Form 10-K.

Independence Disqualifications. A director is not independent if:

- the director is, or during the past three years was, employed by the company, its parent or any subsidiary of the company;³²
- the director or a family member³³ accepts more than \$60,000 in payments from the company, its parent or any subsidiary of the company during the current or any of the past three fiscal years other than: compensation for board or board committee service; payments arising solely from

investments in the company's securities; compensation paid to a family member of a director who is a non-executive employee of the company, its parent or any subsidiary of the company; benefits under a tax-qualified retirement plan or non-discretionary compensation; or loans permitted under Section 13(k) of the Exchange Act;

- a family member of the director is, or during the past three years was, employed as an executive officer, as defined in Exchange Act Rule 16a-1(f), of the company, its parent or any subsidiary of the company;
- the company made or received payments for property or services during the current or any of the past three fiscal years that exceed the greater of \$200,000 or 5% of the recipient's consolidated gross revenues for that year, to or from an entity, including charitable and other not-for-profit organizations, where the director or a family member is a partner (other than a limited partner), controlling shareholder or executive officer of such entity;
- the director or a family member is employed as an executive officer of another entity whose compensation committee included an executive officer of the listed company during the past three years; or
- the director or a family member is a current partner of the company's outside auditor or was a partner or employee of the company's outside auditor who worked on the company's audit during the past three years.³⁴

31 NASD Rule 4350(c)(1). Similar to the NYSE listing standards, stock ownership alone will not preclude a board finding of independence.

32 "Parent" and "subsidiary" refer to entities that are consolidated with the listed company's financial statements.

33 A "family member" is a person's spouse, parents, children, siblings (whether by blood, marriage or adoption) or any person residing in such person's home.

34 NASD Rule 4200(a)(15). These tests for independence do not apply to investment companies. A director of an investment company is not independent if the director is an "interested person," as defined in Section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board or any board committee.

Look-Back Period. In determining whether any disqualifying relationship described above exists, the three-year look-back period begins on the date such relationship ceases. There is no phase-in for the look-back period.

Cure Period. If a company fails to comply with the independence requirements described above because of one vacancy on the board or because one director ceases to be independent due to circumstances beyond his or her reasonable control, the company must become compliant by the earlier of its next annual meeting or one year from the occurrence of the event that caused the non-compliance.³⁵ The company must provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

B. Executive Sessions

Independent directors must meet at regularly scheduled executive sessions at which only independent directors are present.³⁶ Executive sessions should be held at least twice each year in conjunction with regularly scheduled board meetings or at other times.

C. Executive Compensation

Compensation of the CEO and the compensation of all other executive officers must be determined, or recommended to the board for determination, either by a majority of independent directors or by a compensation committee comprised solely of independent directors.³⁷ The CEO may not be present during deliberations on CEO compensation but may be present during deliberations on the compensation of all other executive officers.

One non-independent director may serve on the compensation committee under exceptional

and limited circumstances if three criteria are satisfied. First, the compensation committee must have at least three members. Second, the non-independent director must not be a current officer, employee or family member of an officer or employee. Third, the board must determine that such director's service is required by the best interests of the company and its shareholders. The company must disclose in its next annual proxy statement the service of the non-independent director on the compensation committee, the nature of the relationship between such director and the company and the reasons for the board's determination. A member appointed under such an exception may not serve for more than two years.

D. Director Nominations

Director nominees must be selected, or recommended for the board's selection, either by a majority of independent directors or by a nominations committee comprised solely of independent directors.³⁸ Listed companies must certify that they have adopted a formal written charter or board resolution addressing the nominations process and such related matters as may be required under the federal securities laws.

Similar to the compensation committee, under exceptional and limited circumstances, one non-independent director may serve on the nominations committee if the same three criteria are satisfied: (1) the nominations committee has at least three members; (2) the non-independent director is not a current officer, employee or family member of an officer or employee; and (3) the board determines that such director's service is required by the best interests of the company and its shareholders. The company must disclose in its next annual proxy statement the service of the non-independent director on the nominations committee, the nature

35 NASD Rule 4350(c)(1).

36 NASD Rule 4350(c)(2).

37 NASD Rule 4350(c)(3).

38 NASD Rule 4350(c)(4).

of the relationship between the non-independent director and the company and the reasons for the board's determination. A member appointed under such an exception may not serve for more than two years.

The rule requiring director nomination by independent directors does not apply in cases where (1) either the right to nominate a director legally belongs to a third party or the company is subject to a binding obligation that requires a director nomination structure inconsistent with the rule; and (2) such obligation pre-dates the approval of the new listing standards.

E. Audit Committee

Composition. Listed companies must have an audit committee of at least three members, all of whom must be independent. Audit committee members must satisfy the independence standards for directors described above in Section III.A and the requirements set forth in Rule 10A-3(b)(1).³⁹ Under Rule 10A-3(b)(1), an audit committee member may not accept, directly or indirectly, any consulting, advisory or other compensatory fee from the company or any of its subsidiaries, other than (1) compensation for board or committee service or (2) fixed amounts of compensation under a retirement plan for prior service that is not contingent on future service. In addition, an audit committee member must not have participated in the preparation of the financial statements of the company or any current subsidiary of the company during the past three years, and a member must be able to read and understand fundamental financial statements, including the company's balance sheet, income statement and cash flow statement.

At least one member of the audit committee must have past employment experience in finance or accounting, requisite professional certification in accounting or any other comparable experience or background which results in the individual's financial sophistication. This requirement may be satisfied if a member has served as a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities or if a member qualifies as an audit committee financial expert under Item 401(h) of Regulation S-K. The company must certify that the requirement is satisfied.

A director who does not satisfy the independence requirements for directors under the listing standards but does satisfy the requirements set forth in Rule 10A-3 may serve on the audit committee under exceptional and limited circumstances provided that two criteria are satisfied. First, the director must not be a current officer, employee or family member of an officer or employee. Second, the board must determine that such director's service is required by the best interests of the company and its shareholders. The company must disclose in its next annual proxy statement the service of the non-independent director on the audit committee, the nature of the relationship between such director and the company and the reasons for the board's determination. A member appointed under such an exception may not serve for more than two years and may not chair the audit committee.

Charter. Companies must certify that they have adopted a formal written audit committee charter and that the audit committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis.⁴⁰ The charter must specify the following:

³⁹ NASD Rule 4350(d)(2). A company may cure non-compliance with the independence requirements under two circumstances. First, if a member of the audit committee ceases to be independent for reasons outside the member's reasonable control, the member may continue to serve on the audit committee until the earlier of the company's next annual meeting of shareholders or one year from the occurrence of the event that caused the member to no longer be independent. Second, if the company fails to satisfy the audit committee composition requirements due to one vacancy, the company may allow the vacancy to continue until the earlier of the company's next annual meeting of shareholders or one year from the occurrence of the event that caused the non-compliance. Companies may only rely on one cure period at a time and must provide notice to Nasdaq immediately upon learning of the event of non-compliance.

⁴⁰ NASD Rule 4350(d)(1).

- the committee’s purpose of overseeing the accounting and financial reporting processes of the company and the audits of the company’s financial statements;
- the scope of the committee’s responsibilities and the means by which the committee carries out those responsibilities;
- the specific responsibilities of the committee, as described below;
- the outside auditor’s accountability to the committee; and
- the committee’s responsibility to ensure the independence of the outside auditor.

Responsibilities. The audit committee has the following responsibilities:

- appoint, compensate, retain and provide oversight of the work of the independent auditor;
- establish procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters and procedures for the confidential, anonymous submission by company employees regarding questionable accounting or auditing matters;
- retain and compensate independent counsel and other advisers as the audit committee determines necessary to carry out its duties; and
- determine the appropriate level of funding to be provided by the company for payment of the independent auditor and outside advisers and administrative expenses incurred by the audit committee in carrying out its duties.⁴¹

F. Code of Business Conduct and Ethics

Listed companies must adopt and make publicly available a code of business conduct and ethics for directors, officers and employees.⁴² The code of conduct must satisfy the requirements of Section 406(c) of the Sarbanes-Oxley Act of 2002 and Item 406 of Regulation S-K. The code must provide for an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance and a fair process by which to determine violations. Any waivers of the code for directors or executive officers must be approved by the board and disclosed in a Form 8-K within five days of such waiver.

G. Notification of Non-Compliance

A listed company must promptly notify Nasdaq after any executive officer becomes aware of any material non-compliance with the corporate governance listing standards or other qualitative listing standards.⁴³

H. Going Concern Qualification

Any listed company that receives an audit opinion which contains a going concern qualification must make a public announcement of such fact through the news media.⁴⁴ Prior to the release of the public announcement, the company must provide the text of the public announcement to the StockWatch section of Nasdaq’s MarketWatch Department (“Nasdaq StockWatch”). The public announcement must be provided to Nasdaq StockWatch and must be released to the media not later than seven calendar days following the filing of the audit opinion in a public filing with the SEC.

⁴¹ NASD Rule 4350(d)(3); Exchange Act Rule 10A-3(b)(2), (3), (4) and (5).

⁴² NASD Rule 4350(n).

⁴³ NASD Rule 4350(m).

⁴⁴ NASD Rule 4350(b)(1)(B).

I. Related Party Transactions

All related party transactions must be approved by the audit committee or another independent body of the board.⁴⁵ Related party transactions are defined under the listing standards by reference to Item 404 of Regulation S-K.

J. Exceptions

The new listing standards apply to all companies listed on Nasdaq with the following exceptions:⁴⁶

Controlled Companies. Controlled companies (defined below) are exempt from the requirement that the board have a majority of independent directors as well as the executive compensation and director nominations requirements discussed above in Section III.C and Section III.D, respectively. A “controlled company” is a company of which more than 50% of the voting power is held by an individual, another company or a group of shareholders that have disclosed in a public filing (such as Schedule 13D) that they are acting as a group.⁴⁷ A company relying on the controlled company exemption must disclose its reliance on the exemption, its status as a controlled company and the basis for its determination that it is a controlled company in its annual proxy statement or, if the company does not file an annual proxy statement, in its annual report on Form 10-K. Controlled companies must comply with the audit committee requirements and the executive session requirement.

Management Investment Companies. Management investment companies that are registered under the Investment Company Act of 1940 are

exempt from the requirement that the board have a majority of independent directors, the executive compensation and director nominations requirements and the code of conduct requirement.

Other Companies. There are additional exceptions for cooperative entities (such as agricultural cooperatives), asset-backed issuers and other passive issuers, as set forth in the listing standards.

K. Foreign Private Issuers

Under the previous listing standards, a foreign private issuer could receive an exemption from any listing standard that is contrary to the laws, rules, regulations or generally accepted business practices of the issuer’s home country. Under the new listing standards, the exemption may not be granted if such exemption would be contrary to federal securities laws, including Section 10A(m) of the Exchange Act and Rule 10A-3.⁴⁸ A foreign private issuer receiving an exemption must disclose in its annual reports each requirement from which it is exempted and the home country practice, if any, followed by the issuer in lieu of such requirement. In addition, a foreign private issuer making its initial public offering or first U.S. listing on Nasdaq must disclose such exemptions in its registration statement.

L. Effective Dates

Listed companies (other than foreign private issuers and small business issuers) must comply with the new listing standards related to board independence, executive compensation, director nominations and notification of non-compliance by the earlier of their first annual meeting after

45 NASD Rule 4350(h).

46 NASD Rule 4350(a).

47 NASD Rule 4350(c)(5).

48 NASD Rule 4350(a).

January 15, 2004, or October 31, 2004.⁴⁹ Foreign private issuers and small business issuers have until July 31, 2005 to comply.

If a company has a staggered board and would be required under the new listing standards to change a director who would not normally stand for election at the first annual meeting after January 15, 2004, then such company has until its second annual meeting after January 15, 2004, but not later than December 31, 2005, to implement the requirements related to board composition. Such companies, however, are required to comply with the audit committee requirements by the earlier of their first annual meeting after January 15, 2004, or October 31, 2004.

Companies listing in conjunction with their initial public offering are required to have at least one independent member on each committee at the time of listing, a majority of independent members on such committees within 90 days of listing and fully independent committees within one year after listing. Companies that choose not to establish a compensation or nominations committee must meet the majority of independent directors requirement within 12 months of listing.

Companies that transfer from another market to Nasdaq have 12 months from the date of transfer to comply with the new listing standards to the extent the market on which they were listed did not have the same requirement. If the former market has a substantially similar requirement and the company has an unexpired transition period with respect to such requirement, the transferring company may rely on the unexpired transition period from the former market.

The code of conduct requirements must be implemented by May 4, 2004, and the related party transactions requirements are effective on January 15, 2004. The going concern qualification requirements became effective on November 4, 2004. The requirement that a foreign private issuer disclose the receipt of an exemption from the new listing standards will be effective for new listings and filings made after January 1, 2004. The limitation on Nasdaq's authority to grant such exemptions to foreign private issuers is not effective until July 31, 2005.

IV. Checklist for Companies

The checklist below provides a summary of the steps that companies should take to comply with the new NYSE and Nasdaq corporate governance listing standards.

⁴⁹ Companies are not required to include the new required disclosures in documents filed with the SEC before the effective date. However, companies may want to consider including such disclosures before the effective date to assure shareholders and proxy advice services of compliance with the new listing standards. In addition, Nasdaq likely will be reviewing the upcoming proxy statements to determine whether companies were in compliance as of their annual meeting dates. Companies may be able to reduce future inquiries by Nasdaq staff by including the disclosures in the proxy statements.

	NYSE	Nasdaq
<i>Director Independence</i>	<ul style="list-style-type: none"> Evaluate the independence of directors, affirmatively determine that certain directors are independent and change the board composition, as required, to achieve a majority of independent directors Disclose the board determination regarding director independence in the annual proxy statement (or, if none is filed, the Form 10-K) 	<ul style="list-style-type: none"> Evaluate the independence of directors, affirmatively determine that certain directors are independent and change the board composition, as required, to achieve a majority of independent directors Disclose the board determination regarding director independence in the annual proxy statement (or, if none is filed, the Form 10-K)
<i>Executive Sessions</i>	<ul style="list-style-type: none"> Schedule regular executive sessions for non-management directors Disclose the name of the presiding director, or the procedure for selecting a presiding director, for each executive session and a method for interested parties to communicate directly with the presiding director or with the non-management directors as a group in the annual proxy statement (or, if none is filed, the Form 10-K) 	<ul style="list-style-type: none"> Schedule executive sessions for independent directors at least semi-annually
<i>Nominating Committee</i>	<ul style="list-style-type: none"> Establish a nominating/corporate governance committee or delegate the responsibilities of the nominating/corporate governance committee to another committee that is composed entirely of independent directors and has a written charter Evaluate the independence of the members of the nominating/corporate governance committee, all of whom must be independent Establish a written charter for the nominating/corporate governance committee, display such charter on the company's website and disclose in the Form 10-K that such charter is available on the company's website and is available in print to any shareholder who requests it 	<ul style="list-style-type: none"> Establish a nominations committee, at the company's discretion Evaluate the independence of the members of the nominations committee, if formed, all of whom must be independent Select, or recommend to the board for selection, director nominees by the nominations committee or a majority of independent directors Adopt a formal written charter or board resolution addressing the nominations process and such related matters as may be required under the federal securities laws, and certify such adoption

	NYSE	Nasdaq
<i>Compensation Committee</i>	<ul style="list-style-type: none"> Establish a compensation committee or delegate the responsibilities of the compensation committee to another committee that is composed entirely of independent directors and has a written charter Evaluate the independence of the members of the compensation committee, all of whom must be independent Establish a written charter for the compensation committee, display such charter on the company's website and disclose in the Form 10-K that such charter is available on the company's website and is available in print to any shareholder who requests it 	<ul style="list-style-type: none"> Establish a compensation committee, at the company's discretion Evaluate the independence of the members of the compensation committee, if formed, all of whom must be independent Determine, or recommend to the board for determination, executive compensation by the compensation committee or a majority of independent directors
<i>Audit Committee</i>	<ul style="list-style-type: none"> Establish an audit committee composed of at least three members Evaluate the independence and financial expertise of the members of the audit committee, all of whom must be independent and financially literate and one of whom must have accounting or related financial management expertise (Audit committee members must satisfy a heightened independence standard as described above in Section II.E) Disclose any board determination regarding simultaneous service of any audit committee member who serves on the audit committees of more than three public companies in the annual proxy statement (or, if none is filed, the Form 10-K) Establish a written charter for the audit committee, display such charter on the company's website and disclose in the Form 10-K that such charter is available on the company's website and is available in print to any shareholder who requests it 	<ul style="list-style-type: none"> Establish an audit committee composed of at least three members Evaluate the independence and financial sophistication of the members of the audit committee, all of whom must be independent and one of whom must have the requisite financial sophistication (Audit committee members must satisfy a heightened independence standard as described above in Section III.E) Certify that the financial sophistication requirement is satisfied Adopt a written charter for the audit committee and certify annually that the audit committee has reviewed and reassessed the adequacy of such charter

	NYSE	Nasdaq
<i>Internal Audit Function</i>	<ul style="list-style-type: none"> Maintain an internal audit function or outsource the internal audit function to a third party other than the independent auditor 	(no comparable Nasdaq listing standard)
<i>Corporate Governance Guidelines</i>	<ul style="list-style-type: none"> Adopt and disclose corporate governance guidelines, display such guidelines on the company's website and disclose in the Form 10-K that such guidelines are available on the company's website and are available in print to any shareholder who requests them 	(no comparable Nasdaq listing standard)
<i>Code of Business Conduct and Ethics</i>	<ul style="list-style-type: none"> Adopt and disclose a code of business conduct and ethics, display such code on the company's website, disclose in the Form 10-K that such code is available on the company's website and is available in print to any shareholder who requests it and disclose any waivers from such code 	<ul style="list-style-type: none"> Adopt and make publicly available a code of business conduct and ethics and disclose any waivers from such code in a Form 8-K, as required
<i>CEO Certification</i>	<ul style="list-style-type: none"> Provide annual CEO certification to the NYSE regarding compliance with the corporate governance listing standards Disclose the CEO certification and any CEO/CFO certifications required to be filed with the SEC under Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 in the annual report to shareholders (or, if none, in the Form 10-K) 	(no comparable Nasdaq listing standard)
<i>Going Concern Qualification</i>	(no comparable NYSE listing standard)	<ul style="list-style-type: none"> Make a public announcement through the media of any audit opinion that contains a going concern qualification and provide such announcement to Nasdaq StockWatch and to the public media, as required
<i>Related Party Transactions</i>	(no comparable NYSE listing standard)	<ul style="list-style-type: none"> Approve, by the audit committee or another independent body of the board, any related party transaction

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