

SEC APPROVES FINAL NYSE/NASDAQ RULES REQUIRING SHAREHOLDER APPROVAL OF EQUITY COMPENSATION PLANS

The Securities and Exchange Commission (“SEC”) has approved final rules¹ proposed and adopted by the New York Stock Exchange (“NYSE”) and the National Association of Securities Dealers, Inc., through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”), requiring listed companies to obtain shareholder approval of the adoption or material amendment of equity compensation plans for employees, directors or service providers. The SEC also approved a related NYSE rule prohibiting brokers from voting on equity compensation plans unless the beneficial owner of the securities has given voting instructions. The new shareholder approval rules apply to equity compensation plans that are adopted, or materially amended, on or after June 30, 2003 (the “Effective Date”), subject to certain transition provisions discussed below. The NYSE’s broker voting rule will be effective for shareholder meetings that occur on or after September 28, 2003.

Adoption of Equity Compensation Plans

The final rules eliminate the prior NYSE and Nasdaq exception to the shareholder approval requirement for certain broadly-based plans, and the Nasdaq “de minimus” exception. The new rules require shareholder approval of any plan or arrangement that provides for the delivery of any equity security, whether newly issued or distributed from treasury, to any employee, director or service provider as compensation for services. Plans that provide for equity-based awards that settle *only* in cash, such as cash-settled stock appreciation rights or phantom stock units, are not subject to the rules. The rules also do not apply to plans or arrangements made available to all shareholders, such as dividend reinvestment plans, or plans that merely allow for the purchase of shares on the open market or from the listed company at fair market value. The NYSE rules clarify that fair market value purchase plans are excluded from coverage regardless of whether stock is delivered immediately or deferred, and regardless of whether purchases are made directly or through payroll deductions.

Material Amendments

Once an equity compensation plan has been approved by shareholders, or grandfathered under the transition provisions described below, any subsequent material amendment must also be approved. The final rules delineate examples of amendments or revisions that are deemed material, including but not limited to (i) a material increase in the number of shares available under the plan, (ii) any expansion of the types of awards provided for under the plan, (iii) a material expansion of the class of eligible participants, (iv) a material extension of the term of

¹ SEC Release No. 34-48108 (June 30, 2003).

the plan, (v) a material change in the method of determining the exercise price for options (under the NYSE rules) or a material change to reduce the price at which shares or options may be offered (under the Nasdaq rules), and (vi) any change that permits, or lessens the restrictions on, option repricing.

The final rules provide further guidance with respect to plans that contain a formula for automatic share increases (such as so-called “evergreen features”) or automatic awards (including employer matching contributions under plans that are not tax-qualified) (“Formula Plans”)² and plans that contain no share limit (“Discretionary Plans”). The NYSE rules provide that each automatic grant and automatic share increase under a Formula Plan is considered a material amendment unless the term of the Formula Plan is limited to no more than ten years. The Nasdaq rules require shareholder approval of a Formula Plan every ten years (if the term exceeds ten years). Under both the NYSE and Nasdaq rules, each new grant under a Discretionary Plan requires shareholder approval.

The NYSE rules clarify that amendments which curtail, rather than expand, the scope of a plan will not be considered material. Under the Nasdaq rules only, where a shareholder-approved plan permits a specific action without shareholder approval (except in the case of a Formula Plans and Discretionary Plans, discussed above), no further shareholder approval would be required.

Repricings

Under the NYSE rules, a plan is deemed to prohibit repricings unless they are expressly permitted under the terms of the plan. The Nasdaq rules merely recommend that plans which are intended to permit repricings state so explicitly. The NYSE rules define repricing as: (i) lowering the strike price of an outstanding option; (ii) any action that is treated as a repricing under generally accepted accounting principles; (iii) canceling an underwater option in exchange for another option, restricted stock award or other equity award, except in connection with a corporate transaction (such as a merger); or (iv) any other action that has the same effect as (i), (ii) or (iii). As a result, all repricings, including those that avoid variable accounting treatment by providing for a six-month and one-day waiting period between the option cancellation date and the date new options are granted, will need shareholder approval under the NYSE rules. The Nasdaq rules do not define repricing, but in the absence of specific guidance, it may be prudent for Nasdaq listed companies to interpret the rules in a manner consistent with the NYSE definition.

² Under the Nasdaq rules, a plan which provides for automatic grants but does not contain an evergreen feature will be considered a Formula Plan only if the formula for determining the number of securities to be granted is based on a dollar value, as opposed to a specific number of securities.

Exemptions

Certain types of grants, plans and amendments are exempt from the shareholder approval requirements. As discussed more fully below, the exemptions include (i) employment inducement awards, (ii) certain grants or plans made, adopted or amended in connection with a merger or acquisition, and (iii) certain tax-qualified plans and excess benefit plans. The NYSE rules require that all exempt transactions be approved by the listed company's independent compensation committee or a majority of the company's independent directors. The Nasdaq rules require such approval for employment inducement awards and the adoption or material amendment of tax-qualified plans and excess benefit plans. Both the NYSE and Nasdaq rules require written notification to the exchanges following the grant of awards or the adoption or amendment of a plan pursuant to an exemption.

Employment Inducement Awards. Employment inducement awards are awards granted to individuals as a material inducement to enter into employment with the listed company, and grants to new employees in connection with a merger or acquisition. The NYSE rules require companies utilizing this exemption to issue a press release promptly following the grant, disclosing the name(s) of the recipient(s), the number of shares granted and other material terms. Nasdaq is considering whether to require public disclosure when a company relies on this or any other exemption.

Mergers and Acquisitions. The rules provide for two types of exemptions in connection with a merger or acquisition. First, the conversion, replacement or adjustment of an outstanding award to reflect the terms of the transaction is exempt. Second, shares available under certain plans acquired in a merger or acquisition may be used for certain post-transaction grants without further shareholder approval. This second exemption applies to shares available under pre-existing shareholder-approved plans of companies whose shares are no longer listed following the transaction. Shares available under such pre-existing plans may be used to grant options and awards with respect to the securities of the post-transaction listed company, either under the pre-existing plan or another plan, without further shareholder approval, provided (i) the number of shares available under the pre-existing plan is appropriately adjusted to reflect the terms of the transaction, (ii) the time during which the shares are available for grant under the pre-existing plan is not extended; and (iii) post-transaction awards are not granted to individuals who were employed by the post-transaction listed company or its subsidiaries immediately prior to the transaction. Shares issued under either of these exemptions are counted by the NYSE and Nasdaq in determining whether the transaction involves the issuance of 20% or more of the listed company's outstanding common stock, thus requiring shareholder approval under Section 312.03(c) of the NYSE Listed Company Manual or Nasdaq Rule 4350(i)(1)(C), as applicable.

Tax-Qualified and Excess Benefit Plans. Plans intended to meet the requirements of Section 401(a) or 423 of the Internal Revenue Code of 1986, as amended (the "Code"), such as 401(k) plans, ESOPs and Section 423 employee stock purchase plans, as well as certain excess benefit

plans (“Parallel Excess Plans”) are also exempt.³ A Parallel Excess Plan is defined as a pension plan under the Employee Retirement Income Security Act of 1974, as amended, that (i) covers all or substantially all of the participants in a related 401(a) plan whose annual compensation is in excess of the Code Section 401(a)(17) limits, (ii) is designed to work in parallel with the related 401(a) plan to provide benefits in excess of certain 401(a) limitations, and (iii) limits employer equity contributions to no more than 25% of a participant’s cash compensation.

Transition Rules

Both the NYSE and Nasdaq rules provide generally that plans adopted prior to the Effective Date (whether previously approved by shareholders or adopted pursuant to a prior exemption) will not be subject to shareholder approval unless they are materially amended after such date. The NYSE rules, however, provide special transition rules for Formula Plans and Discretionary Plans. For Formula Plans that either (i) have not previously been approved by shareholders or (ii) do not have a term of ten years or less, additional grants can be made after the Effective Date without shareholder approval only for a limited transition period. Similarly, additional grants under Discretionary Plans can be made after the Effective Date without shareholder approval only for a limited transition period and only in a manner consistent with past practice. In either case, the transition period runs from the Effective Date through the earlier of (i) the date of the listed company’s next annual meeting of shareholders occurring after December 27, 2003, (ii) June 30, 2004, or (iii) the expiration of the plan.

The NYSE rules also provide that grants can continue to be made after the transition period under a shareholder-approved Formula Plan without a limited term if the plan is amended to provide for a term of not more than ten years from the date of original adoption, or more recent shareholder approval, even if the plan contains an “evergreen” feature providing for automatic increases in the number of shares available for grant after the Effective Date. Grants under a Formula Plan not previously approved by shareholders can continue to be made beyond the Effective Date, but only from the shares available for grant under the plan immediately prior to the Effective Date.

The Nasdaq rules do not provide additional transition guidance with respect to Formula Plans or Discretionary Plans. As a result, each new grant under a Discretionary Plan maintained by Nasdaq listed company after the Effective Date will require shareholder approval. Formula Plans maintained by Nasdaq listed companies can continue in effect beyond the Effective Date, unless materially amended, until the earlier of the ten-year anniversary of their adoption or the most recent shareholder approval.

³ The NYSE rules extend this exemption to equity compensation plans that provide substantially the same benefits to non-U.S. employees but for features designed to comply with foreign tax laws.

NYSE Broker Voting

The SEC also approved an amendment to NYSE Rule 452 relating to broker voting on equity compensation plans. Effective for shareholder meetings that occur on or after September 28, 2003, NYSE member organizations will be precluded from giving a proxy to vote on the adoption or material amendment of any equity compensation plan, regardless of whether shareholder approval is actually required under the provisions described above, unless the beneficial owner of the shares held by the broker has given voting instructions. This amendment expands the prohibition on undirected broker voting on equity compensation plans, which previously applied only to plans that authorize the issuance of stock in an amount exceeding 5% of the company's total outstanding shares.

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The foregoing is a summary of the principal provisions of the final rules. If you wish to obtain additional information regarding the new rules, please contact Frank A. Daniele (212-728-8216, fdaniele@willkie.com), J. Pasco Struhs (212-728-8109, pstruhs@willkie.com) or the partner who regularly works with you.

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