

NASDAQ PROPOSES RULE CHANGES TO STRENGTHEN CORPORATE GOVERNANCE STANDARDS

On May 24, 2002, the Nasdaq Stock Market, Inc. (“Nasdaq”) announced that its board of directors had approved modifications to several rules in an attempt to strengthen corporate governance standards and improve disclosure at its listed companies. The proposed rule changes still require the approval of the Securities and Exchange Commission (the “SEC”) following a 21-day comment period. The rules will likely take effect sometime this summer. Nasdaq views these proposed rules as the first step in a continuing attempt to reform corporate governance at its listed companies and may consider another set of proposed rule changes as early as July of this year.

The rule changes will:

- require shareholder approval for all stock option plans that include executive officers or directors;
- require audit committee (or outside director) approval of related-party transactions;
- narrow the definition of an independent director;
- clarify that intentional misrepresentation of information to Nasdaq can lead to delisting;
- require disclosure of audit opinions containing a going concern qualification; and
- allow the dissemination of material information through any Regulation FD-compliant method of disclosure.

For planning purposes, listed companies should monitor in particular the proposed rules relating to shareholder approval for all stock option plans and the required audit committee (or outside director) approval for all related-party transactions (possibly whether or not such transactions are material).

1. Stock Option Plans

Nasdaq rules currently require shareholder approval of all stock option plans in which officers and directors participate unless those plans are “broadly based” (plans in which at least a majority of the options (and other equity-based awards) are granted to participants who are not officers or directors). Under the proposed rules, shareholder approval will be required for all plans in which any officers or directors participate. An existing exemption allowing companies to provide inducement grants to new executive officers without shareholder approval will still be available, so long as the grants are approved by an independent compensation committee or a majority of the company’s independent directors.

2. Related-Party Transactions

Under the current rules, Nasdaq requires that a company's audit committee (or comparable body of directors) review "related-party" transactions. Nasdaq defines a related party as one that can exercise control or significant influence over another party, to the extent that one of the parties may be prevented from pursuing its own separate interests. The new rules will mandate that the audit committee (or comparable body) review and approve all related-party transactions. Nasdaq has not indicated whether the proposed rules will provide for any materiality threshold of a transaction requiring outside director approval.

3. Definition of an Independent Director

The proposed rules narrow the definition of director independence. Currently, independent directors cannot receive more than \$60,000 in compensation from the company for which they serve as independent directors. The proposed rules will prohibit any payments in excess of \$60,000, including political contributions, and also will encompass payments made to a family member of a director.

A director will likewise not be considered independent under the proposed rules if the company makes payments to a charity where the director is an executive officer, providing that these payments exceed the greater of \$200,000 or five percent of either the company's or the charity's revenues.

4. Delisting from Nasdaq as Penalty for Intentional Misrepresentation of Information

The proposed rules make explicit the current implication that an issuer may be delisted for intentionally misrepresenting information, intentionally omitting material information, or otherwise failing to provide requested information, in a communication with Nasdaq.

5. Heightened Disclosure of Audit Opinions with Going Concern Qualifications

Currently, when an auditor concludes that there is substantial doubt about a company's ability to continue as a going concern for a reasonable period of time, the auditor provides this information in the auditor's report, which is available to the public only in the company's Form 10-K. Under the proposed rules, a company will have to disclose the receipt of a going concern qualification through a press release. Nasdaq envisions that this rule will effect more immediate and uniform disclosure of the receipt of going concern qualifications.

6. Disclosure of Material Information as Contemplated in SEC Regulation FD

Nasdaq generally requires that companies promptly disclose material information that would reasonably be expected to affect the value of a company's securities or influence investors' decisions to the public through the news media (news services such as Bloomberg, Dow Jones, Reuters, Business Wire or PR Newswire) only. Under the proposed rules, a company will be

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able to utilize any method that complies with Regulation FD (news media, as well as conference calls, press conferences and webcasts, so long as the public is provided with adequate notice).

If you wish to obtain additional information regarding Nasdaq's proposed rule changes, please contact Steven A. Seidman (212-728-8763, sseidman@willkie.com), Frank Daniele (212-728-8216, fdaniele@willkie.com) or the partner who regularly works with you.

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