



November 2004

UPDATE: NYSE Amends Certain Aspects of its New Corporate Governance Rules

The NYSE has adopted amendments to the corporate governance rules set out in Section 303A of the NYSE Listed Company Manual. The updated rules (the “Amended Rules”), which were approved by the SEC on November 4, 2004:

- make a number of technical revisions to the definition of director independence;
- revise the bright-line director independence test relating to a director’s, or immediate family member’s, relationship to the auditor of the company so that the bar to independence is limited to directors or family members affiliated with the auditor *that were involved on the listed company account*;
- preclude a finding of independence for a director with a family member who is a current partner of the company’s audit firm; and
- provide clarifying language consistent with the NYSE’s views expressed in its FAQ released in January 2004, and updated in February 2004.

Effective Dates

The Amended Rules became effective on November 3, 2004. Companies will have until their first annual meeting after June 30, 2005 to replace a director who was independent under the previous rules, but not under the Amended Rules. Foreign private issuers will have until July 31, 2005 to provide the written affirmations required by Section 303A.12(c).

Definition of Director Independence

Clarifications

Section 303A.02 sets forth a definition of “independent director” and establishes five bright-line tests that directors must satisfy in order to be eligible to be deemed independent for purposes of board and committee membership. The Amended Rules make a number of clarifications with respect to the definition of independence under this section. Specifically, the Amended Rules:

- clarify that companies are required to identify which of their directors are deemed independent;

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- define “executive officer” in the same manner as the term “officer” is defined in Rule 16a-1(f) under the Exchange Act and amend other provisions throughout Section 303A by including this term;
- clarify that service as an interim executive officer (not just an interim Chairman or CEO) will not trigger the look-back provisions in Sections 303A.02(b)(i) (relating to a director or an immediate family member serving as an employee or executive officer, respectively, of a listed company) and 303A.02(b)(ii) (relating to a director or immediate family member receiving \$100,000 in direct compensation from the listed company);
- revise the language of the bright-line independence tests throughout the rule to provide more clarity with respect to how the look-back tests will be applied;
- clarify that the look-back period for directors or family members that receive direct compensation of more than \$100,000 from the listed company is for 36 months, not up to four years; and
- clarify that the bright-line test relating to a director, or director’s family member, who held certain positions in another company that received payments from the listed company does not apply to contributions made to tax exempt organizations. Payments to a charitable organization related to a listed company’s business relationship (for example, as a vendor) will be covered by the test, while contributions would not be covered by the test but would be subject to proxy statement disclosure.

Relationships with the External Auditor

Previously, Section 303A.02(b)(iii) precluded independence where a director or family member is employed by or affiliated with a present or former internal or external auditor. This *per se* bar covers a director or family member that has a current or past affiliation with an auditing firm, even though the person involved never worked on the listed company account. The NYSE notes that both the Nasdaq National Market and the American Stock Exchange standards are narrower.

Under the Amended Rules, this standard now precludes an independence finding if:

- any director, or immediate family member, is a current partner of the audit firm;
- any director is a current employee of the audit firm;
- any director’s immediate family member is a current employee of the audit firm participating in the firm’s audit, assurance or tax compliance (but not tax planning) practice; and

- any director, or immediate family member, was a former partner or employee of the audit firm who personally worked on the listed company's audit during the past three years.

The Amended Rules create a new category of persons that are precluded from serving as an independent director. Section 303A.02(b)(iii) now precludes an independence determination for a director who is, or whose immediate family member is, a current partner of the audit firm. The previous rule only applied to persons "affiliated" with or employed in a "professional capacity" by the audit firm and, therefore, did not necessarily capture current partners of the audit firm.

Additional Rule 303A Clarifications

Requirements for Compensation Committee

The Amended Rules revise Section 303A.05(b) to clarify that the requirement that the compensation committee make recommendations to the board of directors with respect to non-CEO compensation applies to the compensation of executive officers. The Amended Rules also make clear that the board may delegate its authority to approve non-CEO compensation to the compensation committee.

Audit Committee

The Amended Rules revise Section 303A.07(b)(ii)(B) to clarify that the audit committee must *meet* to review and discuss the company's financial statements and the company's *specific* disclosures in the Management's Discussion and Analysis of Financial Condition and Results of Operations.

Non-management Director Meetings

The Amended Rules revise Section 303A.03 to clarify that a non-management director must preside over each executive session of the non-management directors. The same director is not required to preside at all executive sessions of the non-management directors.

Disclosure Relating to Corporate Governance Guidelines and Code of Business Conduct and Ethics

The Amended Rules revise Section 303A.09 to clarify that each listed company must state *in its annual proxy statement or, if the company does not file an annual proxy statement*, in the company's annual report on Form 10-K filed with the SEC that its corporate governance guidelines and audit committee charter, compensation committee charter, nominating committee charter and code of business conduct and ethics are available on its website and available in print to any shareholder who requests them. The references to the proxy statement are new.

Foreign Private Issuer Disclosure

The Amended Rules revise Section 303A.11 to clarify that foreign private issuers are to provide disclosure of the significant differences between the standards mandated by Section 303A and the issuer's actual corporate governance practices, as opposed to general corporate governance practices of the issuer's home country.

Certifications

The Amended Rules revise Section 303A.12 to clarify that qualifications to the annual CEO certification must be specified and disclosed, as well as to clarify that companies must submit Annual and Interim Written Affirmations to the NYSE. Finally, the Amended Rules revise the General Application section to specify that listed Exchange Traded Funds that are open end management investment companies, foreign private issuers and preferred and debt listed companies will be required to submit Annual and Interim Written Affirmations. The NYSE has maintained that these certifications are required, and the revisions simply formalize those requirements.

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Any questions concerning the foregoing should be addressed to any of the following. This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. In addition, memoranda on related topics may be accessed under Securities Group publications on our web site (www.paulweiss.com).

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