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NASDAQ Proposes Corporate Governance Rule Changes

In response to a request in February 2002 from the Chairman of the U.S. Securities and Exchange Commission, The Nasdaq Stock Market, Inc. has begun to review its corporate governance listing standards with the goal of strengthening corporate governance standards for companies listed on Nasdaq. Nasdaq's board of directors approved certain changes on May 22, 2002 that have been submitted to the SEC for approval. These proposed changes will be subject to a public comment period and could be implemented for Nasdaq quoted companies as early as later this summer.

As described in greater detail below, these proposals would:

- mandate shareholder approval of stock option plans in which officers and directors participate;
- narrow the definition of director independence;
- require approval by the audit committee of related party transactions; and
- require through issuance of a press release market notification of going concern qualifications in audit opinions.

The full set of the proposals is available on the Nasdaq website at www.nasdaq.com.

Highlights of Proposed Rule Changes:

Stock Option Plans

Nasdaq rules generally require shareholder approval for all stock option or purchase plans in which officers or directors participate. However, the current rules contain an exception for broadly based plans (i.e. plans in which at least a majority of the participants are not officers or directors). The proposed rule changes would eliminate this exception for broadly based plans and, accordingly, would require shareholder approval for all plans in which officers and directors participate.

The proposal would also eliminate the so-called "treasury share" exception that permits a company to use certain repurchased shares to fund options to executive officers without prior shareholder approval as well as the de minimis exception, which allows for the grant of the lesser of 1% of the number of shares of common stock or 25,000 shares without shareholder approval.

While the exception for inducement grants to new officers would be retained, it is proposed that inducement grants be subject to approval by either (i) a compensation committee comprised solely of independent directors or (ii) a majority of the company's independent directors.

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The exception for tax qualified, non-discriminatory plans such as Employee Stock Ownership Plans would also be retained.

With respect to implementation of the proposed rule, Nasdaq has proposed that existing plans be grandfathered, and that the rule become effective 60 days after SEC approval.

Independent Directors

Nasdaq rules generally require issuers to have an audit committee of at least three members, comprised solely of independent directors. For these purposes, the Nasdaq rules currently define an independent director as a person other than an officer or employee or a person who, in the opinion of the board of directors, has a relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The current rules also specify that the following relationships preclude independence: employment with the listed company, compensation in excess of \$60,000 paid to a director, familial relationships with officers, payments between the listed company and a for-profit company with which the director is associated, and relationships arising from interlocking service on another company's compensation committee.

Nasdaq proposes to extend the current prohibition on the receipt of \$60,000 in "*compensation*" to include "*any payments*" (which would include political contributions) in excess of \$60,000 (other than compensation for board service) and to extend this prohibition to the receipt of such payments by an immediate family member of a director. In addition, Nasdaq proposes to clarify that these rules apply to payments made in the current year. Furthermore, Nasdaq proposes to delete the phrase "for-profit business" from the existing rule so that a director will not be considered independent if the company makes payments to a charity where the director is an executive officer and such payments exceed the greater of \$200,000 or five percent of either the company's or the charity's gross revenues.

Nasdaq has proposed that the changes that modify the definition of independence should be applied to newly listed issuers that begin to trade 60 days or more following the SEC's approval of the proposal. Nasdaq has further proposed that these changes should be applied to currently listed issuers and issuers that begin to trade within 60 days following the SEC's approval of the proposal when such issuer files its first definitive proxy statement that calls for the election of directors, provided that such filing is at least 60 days following the SEC's approval of the proposal.

Related Party Transactions

Nasdaq's conflict of interest rule currently provides that an issuer must conduct an appropriate review of all related party transactions on an ongoing basis and utilize its audit committee or comparable body of the board of directors for the review of potential conflicts of interest. Nasdaq is proposing to expand this rule by requiring the audit committee or comparable body of the board of directors to *approve*, rather than merely *review*, related party transactions.

Nasdaq has proposed that this rule change become effective immediately upon approval by the SEC.

Explicit Prohibition on Misrepresenting Information to Nasdaq

Nasdaq proposes to clarify that an issuer can be delisted for misrepresenting material information to Nasdaq. Current Nasdaq rules do not explicitly state that an issuer that makes a material misrepresentation to Nasdaq, omits necessary material information in a communication with Nasdaq, or otherwise fails to provide requested material information, may be delisted. While Nasdaq

believes that existing rules allow for delisting in these situations, Nasdaq has proposed modifying its rules to clarify this.

Nasdaq has proposed that this rule change would become effective upon SEC approval.

Requirement to Disclose Audit Opinions with Going Concern Qualifications

Nasdaq proposes to require issuers to disclose in a press release the receipt of an audit opinion with a going concern qualification. Ordinarily, if an auditor concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, the auditor provides this conclusion through an explanatory paragraph in the auditor's opinion. While the audit opinion is available in the Form 10-K, the proposed rule change would require that the going concern qualification be brought to the attention of investors and potential investors through a press release issued within seven calendar days after the filing of the Form 10-K. Nasdaq's market surveillance would also have to be notified.

Nasdaq has proposed that this rule change would become effective upon SEC approval.

Additional Corporate Governance Reforms

In addition, Nasdaq has announced that it expects to consider in late June a series of additional corporate governance reforms which are similar to the proposals discussed in the Report of the New York Stock Exchange Corporate Accountability and Listing Standards Committee, which was submitted to the Board of Directors of the New York Stock Exchange on June 6, 2002. The additional proposals that will be considered include requiring:

- a majority of independent directors on corporate boards;
- compensation committees composed solely of independent directors;
- a cooling-off period during which former auditors would be precluded from serving on corporate audit committees;
- expansion of the scope of audit committee authority;
- strengthening continuing education for directors;
- use of corporate codes of conduct and compliance methods; and
- non-U.S. companies to disclose under a new SEC disclosure requirement if they have received waivers of corporate governance standards.

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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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