

## ***Summary of Final Nasdaq Corporate Governance Rules***

### **Executive Summary**

On November 4, 2003, the Securities and Exchange Commission (“SEC”) issued an order approving significant amendments to Nasdaq’s corporate governance requirements. The new requirements are the culmination of a series of proposed rules and amendments from Nasdaq that have occurred over more than a year. The Nasdaq rules require that, among other things:

- A majority of directors be independent, which independence standards have been tightened;
- Independent directors conduct separate regularly scheduled meetings, or “executive sessions,” which are recommended to occur at least twice each year;
- The compensation of the CEO and other executive officers be determined either by a majority of independent directors or a compensation committee comprised solely of independent directors;
- Director nominees be selected either by a majority of the independent directors or a nominations committee comprised solely of independent directors;
- Audit committee members meet more stringent standards of independence and audit committees must assume increased powers and responsibilities;
- The audit committee or another independent body of the board of directors review and approve all related party transactions; and
- A code of conduct applicable to all directors, officers and employees be adopted and disclosed.

In addition, on June 30, 2003, the SEC issued an order approving rule changes of Nasdaq requiring shareholder approval of most equity compensation plans.

### ***Companies subject to the new rules***

The rules apply to all companies with securities listed on the Nasdaq National Market or the Nasdaq SmallCap Market, with certain exemptions for limited partnerships, management investment companies, asset backed issuers, passive issuers organized as trusts or other unincorporated associations, cooperatives that do not have a publicly traded class of common stock and “controlled companies.”

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. Controlled companies are exempt from the requirement to maintain a majority-independent board, as well as the rules pertaining to the compensation of officers and the nomination of directors. However, controlled companies are subject to the new audit committee requirements, as well as the requirement to conduct regularly scheduled “executive sessions” of independent board members. In order for a controlling group to exist, the group must have publicly filed a notice that they are acting as a group (e.g. a Schedule 13D). A company relying on this exemption must disclose in its annual meeting proxy statement that it is a controlled company and the basis for that determination.

### ***Effective dates for new rules***

Nasdaq's new rules will have varying effective dates. In general, companies are required to comply with the rules relating to board independence and independent committees in Rules 4200(a)(15) and 4350(c) and (d), as well as the new notification requirements related to material non-compliance with listing standards, by the earlier of the first annual meeting occurring after January 15, 2004, or October 31, 2004.

In the case of an issuer with a staggered board, with the exception of the audit committee requirements, the issuer will have until its second annual meeting after January 15, 2004, but not later than December 31, 2005, to implement the new requirements related to board composition, if the issuer would be required to change a director who would not normally stand for election at an earlier annual meeting. Newly listed companies are required to comply with all of the board composition requirements within two years after the rules were approved, and will receive any remaining balance of the six-month grace period to comply with all other requirements. Companies transferring from other markets with substantially similar requirements have the same period of time that they would have had if they had remained with the other market.

In addition, the following effective dates are applicable to other provisions of Nasdaq's final corporate governance rule filing:

- The requirements as to a code of conduct will become effective May 4, 2004.
- The requirement that the audit committee approve related party transactions will become effective on January 15, 2004.
- The requirement that issuers receiving an audit opinion containing a going concern qualification make a public announcement disclosing the receipt of such qualification became effective on November 4, 2003.

### ***Director independence requirements***

Nasdaq's final rules require that a majority of the board of directors be comprised of "independent directors." The board of directors is required to make an affirmative determination that individuals serving as independent directors do not have a relationship with the listed company that would impair their independence, which determinations must be disclosed in the company's annual meeting proxy statement. Additionally, the final rules amend Nasdaq's existing definition of "independent director" in a number of ways, with the result that the rules preclude a finding of independence for (1) a person who is an officer or employee of the company or its subsidiaries, (2) any individual having a relationship that in the opinion of the company's board of directors would interfere with the exercise of independent judgment in carrying out the responsibilities of a director, and (3) any of the following persons:

- A director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company.
- A director who accepted or who has a family member who accepted any payments from the company or any parent or subsidiary of the company in excess of \$60,000 during the current or any of the past three fiscal years, other than (i) compensation for board or board committee service, (ii) payments arising solely from investments in the company's securities, (iii) compensation paid to a family member who is a non-executive employee of the company, or a parent or subsidiary of the company, (iv) benefits under a tax-qualified retirement plan, or (v) loans permitted under Section 13(k) of the Exchange Act.
- A director who is a family member of an individual who is, or during the past three years was, employed by the company or by any parent or subsidiary of the company as an executive officer.
- A director who is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments (other than those arising solely from investments in the company's securities or payments under non-discretionary charitable contribution matching programs) for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more.

- A director who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the listed company serve on the compensation committee of such other entity.
- A director who is, or has a family member who 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 at any time during any of the past three years.

Commentary to the final rules states that Nasdaq does not view ownership of company stock by itself as a bar to a finding of independence. Different independence rules are applicable to directors of investment companies.

The definition of the term "family member" as used in the tests for independence described above includes a person's spouse, parents, children and siblings (whether by blood, marriage or adoption) or anyone residing in such person's home. This definition represents a concession by Nasdaq from its original rule proposal, which would have considered any family member in evaluating the director's independence.

### ***Independent directors must conduct executive sessions***

Independent directors must have regularly scheduled meetings, or "executive sessions," at which only independent directors are present. These sessions, which Nasdaq contemplates will occur at least twice a year in conjunction with regularly scheduled board meetings, are designed to encourage and enhance communication among independent directors.

### ***Determination of executive compensation by independent directors***

Nasdaq's final rules require that the compensation of the CEO and all other executive officers of the company must be determined, or recommended to the board for determination, either by (1) a majority of the independent directors or (2) a compensation committee comprised solely of independent directors. The CEO may not be present during voting or deliberations with respect to his or her own compensation. The final rules do not require an issuer to have a compensation committee.

### ***Nomination of directors by independent nominations committee***

Nasdaq's final rules require that director nominees must either be selected, or recommended for the board's selection, either by (1) a majority of the independent directors or (2) a nominations committee comprised solely of independent directors. Each issuer must certify that it has adopted a formal, written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under the federal securities laws. The final rules do not require an issuer to have a nominations committee.

Independent director oversight of director nominations will not apply in cases where the right to nominate a director legally belongs to a third party. However, this does not relieve a company's obligation to otherwise comply with the new rules relating to the composition of committees of the board of directors. In addition, the new director nomination rules are not applicable to a company if the company is subject to a binding obligation that requires a director nomination structure inconsistent with the rule and such obligation pre-dates November 4, 2003, the approval date of these rules.

### ***Exception to executive compensation and director nomination requirements***

Under exceptional and limited circumstances, one director who is not independent and not a current officer or employee or family member of such person may be appointed to a compensation or nominations committee of at least three members if the board determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement subsequent to such determination, the nature of the relationship, and the reasons for the determination. A member appointed under this exception would not be allowed to serve longer than two years.

### ***Heightened independence standards for audit committee membership***

As under existing Nasdaq rules, each issuer will be required by Nasdaq to certify that it has and will continue to have, an audit committee of at least three members, each of whom must:

- in addition to meeting the general director independence requirements described above and contained in NASD Rule 4200(a)(15), (i) satisfy the criteria for independence set forth in Exchange Act Rule 10A-3 under the Exchange Act (*i.e.*, not accept any consulting, advisory or other compensation from the issuer or be an “affiliated person” of the issuer or any subsidiary thereof) and (ii) not have participated in the preparation of financial statements of the company or any current subsidiary of the company at any time during the past three years; and
- be able to read and understand financial statements at the time of appointment to the audit committee, including the balance sheet, income statement and cash flow statement. Audit committee members formerly had a “reasonable period of time” after appointment to the audit committee to develop the required understanding of financial statements.

In addition, each issuer must certify that it has, and will continue to have, at least one member of the audit committee who has 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, including being or having been a CEO, CFO or other senior officer with financial oversight responsibilities. This certification is in addition to the requirement that the company disclose whether its audit committee contains at least one “audit committee financial expert” as required under Item 401(e) of Regulation S-K. Note that this disclosure of whether a company has an “audit committee financial expert” serving on its audit committee is required only in an annual report, although a company may include such information in its proxy or information statement and incorporate that disclosure into its annual report if it complies with the applicable rules for incorporation by reference.

Similar to the existing rules, Nasdaq’s final rules allow the appointment to the audit committee of one director to be a member of the audit committee who (i) is not an “independent director” as defined in NASD Rule 4200(a)(15), (ii) meets the criteria set forth in Exchange Act Rule 10A-3 above (as enacted under Section 10A(m)(3) of the Exchange Act) and (iii) is not a current officer or employee or family member of such officer or employee, if the board, under exceptional and limited circumstances determines that it is in the best interest of the company and its shareholders and discloses the nature of the relationship and the reasons for its determination in the next annual meeting proxy statement (or, if the company does not file a proxy, in its Form 10-K or 20-F) following such determination. An audit committee member appointed in such a manner may not serve longer than two years and may not chair the audit committee.

### ***Duties and responsibilities of audit committee***

Under Nasdaq’s new standards, the audit committee must have the specific audit committee responsibilities and authority necessary to comply with Exchange Act Rule 10A-3 relating to: (1) registered public accounting firms, (2) complaints concerning accounting, internal accounting controls or auditing matters, (3) authority to engage advisors and (4) funding as determined by the audit committee.

The audit committee charter must specify the committee’s purpose of overseeing the accounting and financial reporting processes of the issuer and the audits of the financial statements of the issuer, along with (1) the scope of the audit committee’s responsibilities and the means by which it carries out those responsibilities, (2) the outside auditor’s accountability to the audit committee and (3) the audit committee’s responsibility to ensure the independence of the outside auditor. Consistent with this, the charter must specify all audit committee responsibilities set forth in Exchange Act Rule 10A-3 and its responsibility for ensuring independence of the outside auditors, including the receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company.

### ***Cure periods for audit committee composition requirements***

Nasdaq's new rules provide a cure period for compliance with the audit committee composition requirements as follows:

- If an issuer fails to comply with the audit committee composition requirements under Exchange Act Rule 10A-3 and Nasdaq's new rules because an audit committee member ceases to be independent for reasons outside the member's reasonable control, the audit committee member may remain on the committee until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with the requirement; and
- If an issuer fails to comply with Nasdaq's new audit committee composition requirements (irrespective of any "exceptional and limited circumstances" exception) due to one vacancy on the audit committee, and the cure period is not otherwise being relied upon for another audit committee member, the issuer will have until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement.

A company relying on either of these cure period provisions is required to provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

### ***Approval of related party transactions***

The new standards change NASD Rule 4350(h) to require that the audit committee or another independent body of the board of directors approve related party transactions. For purposes of this rule, "related party transactions" are defined as transactions required to be disclosed pursuant to SEC Regulation S-K, Item 404.

### ***Codes of conduct must be adopted and disclosed***

The new Nasdaq rules require that each issuer adopt a code of conduct for all directors, officers and employees, which must be publicly available. Issuers can satisfy this obligation by adopting one or more codes of conduct. Waivers to the code of conduct for executive officers or directors can only be granted by the issuer's board and must be disclosed, along with the reasons for the waiver, on Form 8-K within 5 business days.

The code of conduct must (1) include those elements necessary to meet the "code of ethics" requirements, as defined by the SEC pursuant to Section 406(c) of the Sarbanes-Oxley Act of 2002 and any rules promulgated thereunder, and (2) provide for an enforcement mechanism ensuring prompt and consistent enforcement of the code, protections for persons reporting questionable behavior, clear and objective standards for compliance and a fair process by which to determine violations.

### ***Notification of non-compliance***

Each Nasdaq-listed company is required to provide Nasdaq with prompt notification after an executive officer becomes aware of any material non-compliance by the company with any of Nasdaq's qualitative listing requirements contained in NASD Rule 4350.

### ***Disclosure of audit opinions with a going concern qualification***

The final rules amend NASD Rule 4350(b) to require issuers that receive an audit opinion containing a going concern qualification to make a public announcement through the news media disclosing the receipt of such qualification. Prior to the release of the public announcement, the issuer would be required to provide the text of the public announcement to the StockWatch section of Nasdaq. The public announcement and notice to Nasdaq must be made no later than seven calendar days following the filing of such audit opinion in a public filing with the SEC.

## Shareholder approval of equity compensation plans

On June 30, 2003, the SEC issued an order approving rule changes of Nasdaq requiring shareholder approval of most equity compensation plans, including plans in which insiders do not participate. The new rules generally require shareholder approval for the adoption of equity compensation plans, including stock option plans, as well as repricings and material amendments to such plans, with certain limited exceptions. The rules eliminate the exception to the shareholder approval requirements for "broadly based" plans and the de minimus exception to the shareholder approval requirement. However, shareholder approval is generally not required for equity compensation plans adopted prior to June 30, 2003 unless such plan is later materially amended.

Examples of amendments that are considered material include amendments that: (i) materially increase the number of shares to be issued under the plan other than to reflect a reorganization, stock split, merger, spinoff or similar transaction or an automatic increase pursuant to an "evergreen" formula where the plan term exceeds 10 years; (ii) materially increase the benefits to participants, such as permitting repricing of outstanding options, reducing the price at which shares or options to purchase shares may be offered, and extending the duration of a plan; (iii) materially expand the class of participants eligible to participate in the plan; and (iv) expand the types of options or awards issuable under the plan.

The final Nasdaq rules state that the following are exempt from the shareholder approval requirements:

- warrants or rights issued generally to all security holders of the company or stock purchase plans available on equal terms to all security holders (such as dividend reinvestment plans);
- tax-qualified employee benefit plans and parallel nonqualified plans, provided such plans are approved by the issuer's compensation committee or a majority of the issuer's independent directors;
- plans that merely provide a convenient way to purchase shares on the open market or from the issuer at fair market value;
- the conversion, replacement or adjustment of equity compensation awards in a merger or acquisition transaction to reflect the transaction;
- post-merger and acquisition grants of equity compensation awards under certain plans acquired in merger or acquisition transactions, provided certain conditions are met; and
- employment inducement grants.

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