

A Biweekly  
Newsletter of  
Federal Securities,  
Corporate &  
Banking Law  
Developments

## SEC Approves NYSE and Nasdaq Rules on Equity Compensation Plans

On June 30, 2003, the Securities and Exchange Commission approved new NYSE and Nasdaq rules, effective immediately, that require shareholder approval of all equity compensation plans, including stock option plans, as well as approval of repricings and any material revisions of existing equity compensation plans. (<http://www.sec.gov/rules/sro/34-48108.htm>)

Under both the NYSE and Nasdaq rules, equity compensation plans are defined very broadly. Both require shareholder approval of most plans and other arrangements prior to issuance of securities. The rules define available exemptions from these rules, provide examples of material revisions, and explain whether existing plans would be treated as either "formula" or "discretionary" plans that could require shareholder approval before making any future grants.

These rules are currently in effect, with transition rules for plans existing prior to June 30, 2003. **Listed companies should immediately determine if their existing plans may still issue grants and whether they now require shareholder approval even if previously approved.** *We will be issuing a client bulletin in the near future that will provide a more in-depth analysis of these complex rules.*

### ■ DELAWARE SUPREME COURT PERMITS SHAREHOLDER CHALLENGE TO MERGER

The Delaware Supreme Court recently permitted the continuation of a shareholders'

lawsuit challenging a merger on the grounds that the directors of the target company were not independent when they approved the merger. *See Krasner v. Moffett, Del. No. 569, 2002, 6/18/03.* A group of shareholders of a company being acquired (i.e., the target company) sued its directors for breach of duty, claiming that five of the seven directors had "disabling conflicts of interest" in approving the merger. Initially, the shareholders' lawsuit had been dismissed because the Delaware trial court found that the stockholders had not proven that the directors who served on the target company's two-member independent special committee had conflicts, and thus the board's decision should be upheld based on the business judgment rule. This is the rule in which courts give boards a high level of deference in making decisions for the company.

On appeal, the Delaware Supreme Court reinstated the lawsuit. It held that the directors, and not the shareholders, had the burden of proving that they met the requirements for applying the business judgment rule. **In considering a merger, whether as the acquirer or as the target, boards should be prepared to prove their decisions qualify for deference by courts under the business judgment rule.**

### ■ OUTSIDE DIRECTORS TAKING INCREASED PRECAUTIONS BEFORE JOINING BOARDS

In the wake of recent corporate scandals, some outside director candidates for public companies have been increasing the amount of due diligence they perform before accepting

ATLANTA  
CHICAGO  
DENVER  
DES MOINES  
FAYETTEVILLE  
IRVINE  
KANSAS CITY  
LINCOLN  
LITTLE ROCK  
NEW YORK  
OKLAHOMA CITY  
OMAHA  
PASADENA  
RICHMOND  
SCOTTSDALE  
WASHINGTON

such offers. Given the passage of the Sarbanes-Oxley Act (and related regulations) and the heightened risk of the corporate environment, board members are now exposed to increasing potential liability. To mitigate this risk, directors now face expanding duties and time commitments. Accordingly, it is no longer unusual for board candidates to request information from a company, including:

- Financial information, including non-public;
- Prior board and audit committee minutes; and
- Personal interviews with senior officers, independent directors, external lawyers and auditors, and/or former employees.

Responses to this increased due diligence have varied. While many companies welcome the inquiries as a sign that the potential outside director is serious and responsible, others have chosen candidates who are not as demanding of management's time. **Companies should be prepared for, and not surprised by, increased due diligence by board candidates and should insist on non-disclosure agreements before sharing confidential information.**

## ■ NASDAQ PROPOSES ADDITIONAL LISTING STANDARDS

Continuing its series of corporate governance reforms, Nasdaq has proposed rules that require disclosure of qualified audit opinions and specify requirements of corporate codes of conduct. Subject to SEC final approval, the proposed rule changes will become effective within 35 days of their publication in the Federal Register.

Under the proposed rules, Nasdaq-listed companies would need to publicly disclose any audit opinion that contains a "going concern" qualification. This is a qualification in which the auditors express their doubts as

to whether a company will remain in existence for the next 12 months.

Also, Nasdaq clarified its earlier proposal requiring Nasdaq-listed companies to adopt a code of conduct for directors, officers and employees. Nasdaq would require a code of conduct to reflect the same requirements as a code of ethics described under the Sarbanes-Oxley Act. The code should also include an enforcement mechanism which assures personnel that the reporting of questionable behavior is protected and encouraged. Any waivers to these requirements would need to be approved by the board and disclosed in the company's next periodic report. **Companies listed on Nasdaq, and those preparing to be listed, should be aware of this potentially new disclosure requirement and should design their codes of conduct to reflect the Sarbanes-Oxley requirements.**

Kutak Rock LLP is a national law firm with more than 325 attorneys located in 16 offices throughout the United States practicing in the areas of corporate, banking and securities law, public and corporate finance and complex commercial litigation matters.

For more information on these or other related topics, please contact any of the following attorneys:

**Paul D. Borja**..... 202-828-2310  
paul.borja@kutakrock.com

**Stephen P. Candelmo** ..... 202-828-2413  
stephen.candelmo@kutakrock.com

**Jeremy T. Johnson** ..... 202-828-2463  
jeremy.johnson@kutakrock.com

### Editor

**Kathleen M. Cochrane** ..... 202-828-2308  
Administrative Assistant  
kathleen.cochrane@kutakrock.com

This newsletter is a publication of Kutak Rock LLP and is intended for general information only. It may be considered advertising under applicable court rules. It is not intended and should not be construed as legal advice. With regard to specific circumstances, each person should seek the advice of his or her attorney. The material in this publication may only be reproduced, in whole or in part, with acknowledgement of its source and copyright.

Copyright © 2003 Kutak Rock LLP. All rights reserved.