

KUTAK ROCK LLP

NEW NASDAQ LISTING STANDARDS REQUIRE SHAREHOLDER APPROVAL OF CERTAIN EQUITY COMPENSATION PLANS

On June 30, 2003, the Securities and Exchange Commission approved new listing standards¹ proposed and adopted by the Nasdaq Stock Market (“NASDAQ”) that require each NASDAQ-listed company to obtain shareholder approval for most equity compensation plans and any material amendments to these plans. The new listing standards are effective immediately and are set forth in amended NASD Rule 4350(i) and new “Interpretative Material,” IM-4350-5. This memorandum outlines the principal provisions of the new listing standards.

What Plans Are Covered?

The listing standards use a very broad description of the types of plans covered under the listing standards. A “stock option or purchase plan or other equity compensation arrangement” in which options or stock may be acquired by officers, directors, employees or consultants of the issuer are subject to the shareholder approval requirements. Even a compensatory grant of options or other equity security that is not made under a formal plan will be considered an equity compensation plan. Therefore, even individual arrangements and informal policies that are not reduced to written form must comply with the provisions of the new listing standard.

There will no longer be an exception for “broad-based” plans, which allowed persons other than officers or directors to receive awards or grants of securities. In addition, the new listing standards specifically revoke the *de minimis* exception, which had allowed for the grant of the lesser of 1% of the number of shares of common stock or 25,000 shares, without shareholder approval.

As a general rule, an equity compensation plan that was adopted before June 30, 2003 will be “grandfathered” and not be subject to the new shareholder approval requirement. However, shareholder approval will be required for any “material amendment” (discussed below) made to a grandfathered plan. A provision in a plan that provides general authority to amend a plan will not eliminate the need for shareholder approval of amendments to the plan. However, if a plan specifically allows for an action to be taken without further shareholder approval, then no such approval would generally be required.²

In addition, pre-existing plans with certain characteristics will require shareholder approval in some cases. These include:

¹ See Release No. 34-48108, June 30, 2003.

² The SEC noted that if a plan permits a specific action without further shareholder approval, the plan must be clear and specific enough to provide meaningful shareholder approval of those provisions.

- Plans in which there is no limit on the number of shares that may be issued under the plan (sometimes called “discretionary” plans). Even if this type of plan was previously approved by shareholders, grants made after June 30, 2003 require shareholder approval each time an individual grant is made under the plan.
- Plans that provide for automatic grants pursuant to a dollar-based formula (such as annual grants based on a certain dollar value, or matching contributions based upon the amount of compensation the participant elects to defer) cannot have a term in excess of 10 years unless shareholder approval is obtained every 10 years. These plans are sometimes referred to as “formula” plans.
- Plans that contain a formula for automatic increase in the number of shares available under the plan (sometimes called “evergreen” plans or formulas) also cannot have a term in excess of 10 years unless shareholder approval is obtained every 10 years.

The new NASDAQ listing standards do not provide for any transition period for awards under these types of plans. Therefore, the shareholder approval requirements apply to all grants made under these plans after June 30, 2003. Additionally, even if grants from these types of plans are made out of treasury shares or repurchased shares, shareholder approval will still be required.³

Certain types of equity compensation plans are generally exempt from the shareholder approval requirements. These plans would include:

- **Employment Inducement Awards.** No shareholder approval is required for stock or options awarded to a person in order to induce him or her to accept employment or a directorship with a listed company (including inducements granted in connection with a merger or acquisition or following a bona fide period of nonemployment), provided that such issuances are approved by either the issuer’s compensation committee comprised of a majority of independent directors or a majority of the issuer’s independent directors.
- **Mergers and Acquisitions.** Shareholder approval is not required under two exemptions in this context. First, no approval is necessary to convert, replace or adjust outstanding options or other equity compensation awards to reflect a merger or acquisition transaction. Second, shares available under the acquired company’s existing plans may be used for certain post-transaction grants by the acquiring company. However, this second exemption applies only if (i) the period for making grants under the acquired plan is not extended and (ii) post-transaction grants under the plan are made only to persons who were employed by the acquired company at the time of the transaction.⁴

³ In general, a company would not be permitted to use repurchased shares to fund options plans or grants without prior shareholder approval.

⁴ Any additional shares available under a plan acquired in a merger or acquisition must be counted in determining whether the merger or acquisition involves the issuance of 20% of more of the acquiring company’s stock, thus

- **Qualified Plans and Parallel Nonqualified Plans.** A plan meeting the requirements of Section 401(a) (e.g., ESOPs and 401(k) plans) or Section 423 (e.g., employee stock purchase plans) of the Internal Revenue Code or any parallel nonqualified plan⁵ is exempted from shareholder approval, provided, however, that these plans are approved by the NASDAQ-listed company's compensation committee (a majority of whom must be independent) or a majority of the company's independent directors.
- **Other Plans.** Warrants or rights issued generally to all security holders or stock purchase plans available on equal terms to all security holders (such as a dividend reinvestment plan) or a plan that merely provides a convenient way to purchase company shares on the open market or from the company at current fair market value (such as a payroll deduction plan) do not require shareholder approval.

Material Amendments

The listing standards do not provide a definition of the term "material amendment" and, therefore, some degree of judgment will be needed to determine when a shareholder vote is required to approve a plan amendment. However, the Interpretative Material provides a nonexclusive list of items that will be considered material amendments in all cases. These include amendments that:

- Materially increase the number of shares to be issued under the plan (other than increases to reflect a stock split, reorganization, merger, spinoff or similar transaction).
- Materially increase benefits to participants, including any material change to: (i) permit a repricing (or decrease in exercise price) of outstanding options, (ii) reduce the price at which shares or options to purchase shares may be offered, or (iii) extend the duration of a plan.
- Materially expand the class of participants eligible to participate in the plan.
- In any way expand the types of options or awards provided under the plan.

Notice to NASDAQ

Concurrent with the new listing standards, NASDAQ made a conforming change to NASD Rule 4310(c)(17)(A) which will require issuers to notify NASDAQ on the appropriate form at least 15 days prior to establishing or materially amending a stock option plan, purchase

requiring approval of the merger or acquisition by the shareholders of the acquiring company as well as those of the target company.

⁵ "Parallel nonqualified plan" means a plan that is a "pension plan" under the Employee Retirement Income Security Act ("ERISA") that is designed to work in parallel with a plan intended to be qualified under Section 401(a) of the Internal Revenue Code (the "Code") to provide benefits that exceed the limits (or any successor or similar limitations that may thereafter be enacted) set forth in Section 402(g), Section 401(a)(17), and/or Section 415 of the Code.

plan or other equity compensation arrangement pursuant to which stock may be acquired by officers, directors, employees or consultants without shareholder approval.

Further Questions

If you have questions in connection with the issues addressed in this Memorandum, please contact your relationship partner or any of the following attorneys in our Omaha office at 402-346-6000:

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