

# KUTAK ROCK LLP

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## NEW NYSE LISTING STANDARDS REQUIRE SHAREHOLDER APPROVAL OF CERTAIN EQUITY COMPENSATION PLANS

On June 30, 2003, the Securities and Exchange Commission approved new listing standards<sup>1</sup> proposed and adopted by the New York Stock Exchange (“NYSE”) that require each NYSE-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 new Section 303A(8) of the NYSE Listed Company Manual. This memorandum outlines the principal provisions of the new listing standards.

### What Plans Are Covered?

The listing standards use a very broad definition of the term “equity compensation plan” to encompass any plan or other arrangement that provides for the delivery of equity securities (whether stock, stock options or other forms of equity securities) of the listed company to any employee, director or other service provider as compensation for services. 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. In addition, the new listing standards specifically revoke the “treasury stock exception” under the previous standard.

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 revision” (discussed below) made to a grandfathered plan. In addition, certain types of pre-existing plans will be subject to the new shareholder approval requirement even if no amendment is made to them. These include:

- **Discretionary Plans** in which the number of shares that may be issued under the plan is not fixed. Whether or not the plan was previously approved by shareholders, grants made after June 30, 2003 may be made without shareholder approval only during a limited transition period (described below), and only in a manner consistent with past practices. After that time, all grants are subject to shareholder approval.<sup>2</sup>

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<sup>1</sup> See Release No. 34-48108, June 30, 2003.

<sup>2</sup> If the plan can be separated into discretionary and nondiscretionary segments, only the discretionary segment is subject to the transition period. The nondiscretionary segment would be grandfathered.

- **Formula Plans** that provide for automatic grants pursuant to a formula. Grants may be made under these plans only during the transition period unless the plan (i) was previously approved by shareholders and (ii) has a term of no more than 10 years. If the plan has been previously approved by shareholders, but has a term of more than 10 years, it must be amended to reduce the term to 10 years or less in order to avoid the need for further shareholder approval after the transition period.<sup>3</sup>
- **Evergreen Plans** that contain a formula for automatic increase in the number of shares available under the plan. Grants may be made under these plans only during the transition period unless the plan (i) was previously approved by shareholders and (ii) has a term of no more than 10 years. If both do not apply, then the plan must be approved again by shareholders before any shares that become available due to the application of the formula are awarded.

The transition period for grants under these plans will end at the earliest of (i) the company's next annual shareholders' meeting that occurs after December 27, 2003, (ii) June 30, 2004 or (iii) the expiration of the plan.

Certain types of equity compensation plans adopted after June 30, 2003 may also be 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 with a listed company, including via a merger or acquisition or following a bona fide period of nonemployment.<sup>4</sup>
- **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 number of shares available under the plan is appropriately adjusted to reflect the transaction, (ii) the period for making grants under the acquired plan is not extended and (iii) post-transaction grants under the plan are not made to persons who were employed by the acquiring company at the time of the transaction.
- **Qualified Plans and Parallel Excess Plans.** A plan intended to meet the requirements of Section 401(a) (e.g., ESOPs and 401(k) plans) or Section 423

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<sup>3</sup> The new listing standards provide that an amendment to reduce the term can be made without the need for shareholder approval, although the amendment provisions of the plan itself must be considered.

<sup>4</sup> Following the grant of any inducement under this exemption, the listed company must disclose in a press release the material terms of the grant, including the recipient and the number of shares involved.

(e.g., employee stock purchase plans) of the Internal Revenue Code or any parallel excess plan<sup>5</sup> is exempted from shareholder approval.

- **Other Plans.** Plans made available generally to shareholders (such as a dividend reinvestment plan) or a plan that allows employees, directors or service providers to purchase company shares on the open market or at current fair market value (such as a payroll deduction plan) do not require shareholder approval.

In cases where shareholder approval is not required, however, the plans, amendments and/or awards must still be approved by the company's compensation committee (or a majority of its independent directors), and the NYSE must be informed in writing of the use of the exemption.

### Material Revisions

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

- Materially increase the number of shares available under the plan (other than increases solely to reflect a stock split, reorganization, merger or similar transaction).
- Expand the types of awards available under the plan.
- Materially expand the class of person eligible to receive awards under or participate in the plan.
- Materially extend the term of the plan.
- Materially change the method for determining the strike price of options under the plan.
- Delete or limit any provision prohibiting repricing of options (see separate section below).

### Repricings

Under the listing standards, a plan that does not specifically permit the repricing of stock options will be considered to prohibit such repricing. Therefore, with such a plan, any actual

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<sup>5</sup> "Parallel excess 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.

repricing will be considered a material revision of the plan under Section 303A(8). “Repricing” means:

- Lowering the strike price of an option after the grant date.
- Any other action treated as a repricing under GAAP.
- Canceling an option at a time when its strike price exceeds the fair market value of the underlying security (i.e., an “out-of-the-money” option) in exchange for another option, restricted stock or other equity, unless such cancellation and exchange is in connection with a merger, acquisition, spinoff or such similar corporate transaction.

### **Broker Voting**

The NYSE also amended Rule 452 to prohibit its member brokers holding “street name” shares from voting on equity compensation plan proposals unless the beneficial owner of the shares has provided the broker with voting instructions. This elimination of broker discretion on voting may make it more difficult to obtain the necessary vote on these proposals.

### **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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