NYSE Proposes Changes to its Corporate Governance Rules

On August 26, 2009, the New York Stock Exchange (NYSE) submitted for Securities and Exchange Commission (SEC) approval proposed changes to the NYSE's corporate governance listing rules. While the NYSE intends for these amendments to become effective on January 1, 2010, the SEC has not yet issued this proposal for comment.

The NYSE's proposed rule changes would clarify certain disclosure requirements, codify certain interpretations and replace certain disclosure requirements by incorporating applicable disclosure requirements of SEC Regulation S-K. Some of the proposed changes are in the nature of reorganizing or rephrasing existing items to achieve greater clarity, while others eliminate dates and references that are no longer applicable. The key proposed amendments are discussed below.

General Corporate Governance Rules

Incorporation of SEC Rules. One of the ways in which the NYSE is proposing to revise its corporate governance disclosure requirements is to eliminate some of its specific disclosure requirements and instead rely on the SEC's disclosure requirements set forth in Item 407 of Regulation S-K. The NYSE believes that Item 407 duplicates and, in some instances, requires more detailed disclosures than current NYSE listing standards.

For example, if this rule change is approved, the commentary to Section 303A.02 of the NYSE Listed Company Manual will no longer specify that the board may adopt and disclose categorical standards for independence, and that the board must explain any determination of independence for a director who does not meet such categorical standards. Instead, the amended commentary will state that the listed company must comply with the disclosure requirements set forth in Item 407(a) of Regulation S-K, Item 407(a)(3) of which specifies that for each director and nominee for director that is identified as independent, a company must describe, by specific category or type, any transactions, relationships or arrangements not otherwise disclosed pursuant to the related person transaction disclosure requirements of Item 404(a) of Regulation S-K that were considered by the board of directors in making the independence determination. One impact of this proposed rule change would be that if a company's proxy disclosure is insufficient for the purposes of Item 407 of Regulation S-K, that company will also be deemed to be out of compliance with the NYSE's listing rules.

Other NYSE disclosure items that would be eliminated and replaced with references to the applicable requirement of Item 407 of Regulation S-K include:

- Section 303A.00 controlled company exemption disclosure requirements;
- Section 303A.05 compensation committee charter requirement to produce a compensation committee report; and
- Section 303A.07 audit committee charter requirement to prepare an audit committee report.

Web Site Posting and Disclosure. As proposed, the web site posting requirements for committee charters, corporate governance guidelines and the code of business conduct and ethics will be set forth in a "website posting requirement" section of the specific subsection of Section 303A of the Listed Company Manual containing the substantive requirements for each such document, and these section-specific web site posting requirements will replace the current requirements contained in Section 303A.09 and 303A.10 of the Listed Company Manual. Substantively, listed companies would no longer be required to provide hard copies of charters, guidelines and codes upon request.

The proposed changes also would provide an option to make more extensive use of web site disclosure. Companies would have the option of reporting specified matters in their proxy statement or annual report filed with the SEC or making the applicable disclosure on their web sites. This option would be extended to disclosure of:

- Contributions made by the listed company to tax exempt organizations on which any independent director serves as an executive officer;
- Disclosures with respect to the director chosen to preside at executive sessions or the procedure by which a presiding director is chosen;
- The method for interested parties to communicate directly with the presiding director or the non-management or independent directors as a group; and
- Board determinations with respect to audit committee members serving on more than three public company audit committees.

Executive Sessions. If the proposed rules are adopted, Section 303A.03 of the Listed Company Manual will give listed companies the option to hold regular executive sessions of independent directors only, without any need to hold regular executive sessions of non-management directors. This provision also would clarify that all interested parties, not just shareholders, must be able to communicate their concerns to the presiding director or to the non-management or independent directors as a group.

Audit Committee Matters. The proposed changes make several clarifications with respect to audit committees. If an audit committee member simultaneously serves on more than three public company audit committees, the amended rule would require the company to disclose that the board has determined that such simultaneous service would not impair the ability of that director to effectively serve on its audit committee, regardless of whether the company limits audit committee members to serving on three or fewer public company audit committees. Also, the NYSE commentary on requirements for audit committees would specifically note that Rule 10A-3 pursuant to the Securities Exchange Act of 1934 requires disclosure of reliance on certain exceptions contained in Rule 10A-3. Additional commentary would clarify that audit committee meetings may be telephonic if permitted by applicable corporate law, but that polling of individual audit committee members in lieu of meetings is not permitted.

Waivers of Code of Conduct. Conforming with Form 8-K disclosure requirements, the proposed changes specify that a waiver of the code of business conduct and ethics granted to executive officers and directors must be disclosed within four business days of such determination and that such disclosure must be made by press release, web site disclosure or Form 8-K. This proposal represents a slight variation from the NYSE's response to frequently asked questions which provides for disclosure of any such waiver within two to three business days of the board's determination.

Certification Requirements. If the SEC approves the proposed amendments, listed companies will no longer be required to disclose in their annual reports that they filed the CEO certification required by the NYSE and the certifications required by the SEC. Listed companies would, however, be required to notify the NYSE if any executive officer becomes aware of any non-compliance with the NYSE's corporate governance requirements, regardless of whether the non-compliance is material.

Disclosure Requirements. The proposed amendments specify that if a listed company is required to make a disclosure in a proxy statement or an annual report filed with the SEC, the company may do so by incorporation of the disclosure by reference to another SEC filing, rather than repeating the required disclosure in the proxy statement or annual report. As proposed, the NYSE's corporate governance rules would also expressly state that if a company is not required to file a Form 10-K (for example, a foreign private issuer or a closed-end investment company), references to permitted disclosures on annual reports on Form 10-K would be interpreted as meaning the annual report that a listed company files with the SEC.

Corporate Governance Rules in Specialized Circumstances

IPOs and Spin-Offs. Reflecting market practice, the proposed amendments define "listing date" for purposes of the corporate governance rules as the date a company's securities first trade on the NYSE, either in the regular way or when issued. This date is then used for measurement purposes of transition rules. The transition rules applicable to initial public offerings have been expanded to specifically address spin-offs and carve-outs, with some subtle differences in the timing.

Using the newly defined concept of listing date, the proposed amendments provide that, for companies listing in connection with an IPO, spin-off or carve-out, a majority of the board would have to be fully independent within one year of the listing date. The web site posting requirements in the case of an IPO would have to be met by the earlier of the closing date or five business days from the listing date, and by the closing date in the case of a spin-off or carve-out transaction. At least one member of the nominating committee and one member of the compensation committee would have to be independent by the earlier of the closing date or five business days from the listing date, in the case of an IPO, or by the closing date for a spin-off or carve-out transaction. At least a majority of the members of the nominating and compensation committees would have to be independent within 90 days of the listing date of an IPO, spin-off or carve-out and those committees must consist solely of independent directors within one year of the listing date.

Following an IPO, spin-off or carve-out, audit committees would have to comply with the SEC's Rule 10A-3 as of the listing date. In addition, in the case of a company listing on the NYSE in conjunction with an IPO, spin-off or carve-out, a majority of the company's audit committee members would have to be independent within 90 days of the effectiveness of its registration statement; all of the company's audit committee members would have to be independent by the first anniversary of such effective date.

Under the proposed amendments, companies going public or being spun-off or carved-out could phase in their compliance with the three-member audit committee minimum requirement so that they have at least one member by the listing date, two members within 90 days of the listing date and three members within one year of the listing date. Alternatively, those companies could choose to have non-independent directors on the audit committee during the phase-in period. The amendments clarify that any company that was required to file periodic reports with the SEC prior to listing is precluded from including non-independent directors on its audit committee during the phase-in period.

Emergence from Bankruptcy. Under the amendments, companies emerging from bankruptcy would be required to have a fully compliant audit committee at the time of listing unless an exemption is available under Rule 10A-3. The other independence transition rules applicable to companies emerging from bankruptcy would be comparable to companies listing in connection with an IPO, but the applicable dates will run from the listing date.

Transferring from Another Market. The one-year transition rule for companies transferring from a market that did not have the same listing requirements as the NYSE would only apply to companies registered pursuant to Section 12(b) of the Exchange Act that transfer to the NYSE. If the other exchange had a transition period that has not expired, the transferring company would have the same transition period that would have been available to it under the other exchange. Companies registered pursuant to Section 12(g) of the Exchange Act would have the same transition rules as companies listing in conjunction with an IPO, with the transition period measured from the listing date. Section 12(g) companies would be permitted to have only independent directors on the audit committee during the transition period.

Ceasing to be a Controlled Company. Companies that cease to be controlled companies would be able to phase in majority independent boards and independent nomination and compensation committees on the same schedule as companies listing in conjunction with an IPO, with the transition date measured from the date the company ceased to be a controlled company. For purposes of clarification, the proposed amendments specify that to be deemed a controlled company, more than 50 percent of the voting power *for the election of directors* must be held by an individual, group or another company.

Ceasing to be a Foreign Private Issuer. Status as a foreign private issuer under the SEC rules is measured annually at the end of the most recently completed second fiscal quarter. The proposed amendments specify that within six months after the determination date on which a company ceases to qualify as a foreign private issuer, such company must:

- Satisfy the majority independent board requirement;
- Satisfy the web site posting requirements;
- Have a fully independent nominating and compensation committee;
- Have a three-person audit committee whose members comply with the applicable independence requirements; and
- Comply with the shareholder approval requirements for equity compensation plans.

Under the proposed amendments, the transition period applicable to the shareholder approval requirement for equity compensation plans when a company ceases to be a foreign private issuer would end on the later of:

- Six months after the determination date on which a company ceases to qualify as a foreign private issuer; and
- The first annual meeting after such determination date.

A shareholder-approved formula plan would be permitted to be used after the end of the transition period for a company that is no longer a foreign private issuer if it is amended to provide for a term of ten years or less from its original adoption or, if later, its most recent shareholder approval. Such amendment would not require shareholder approval. A formula plan could continue to be used without shareholder approval if grants after the company's status changed are based only on shares available before the company lost its foreign private issuer status.

Foreign Private Issuer Disclosure. A foreign private issuer that is required to file a Form 20-F with the SEC must include a statement of significant corporate governance differences in that annual report. Other foreign private issuers may either include such statement of differences in the annual report they file with the SEC or make the statement available on their web site. If the web site option for disclosure of significant differences is chosen, the company must disclose that fact in the annual report it files with the SEC and provide the web site address.

Practical Considerations

While it is not certain if the SEC will approve the proposed amendments as submitted by the NYSE, in the time frame envisioned by the NYSE, listed companies should be aware that some of the proposed changes could affect proxy statement or annual report disclosure for the upcoming proxy season. Therefore, it is worthwhile to pay attention to developments in this area this fall.

If you have any questions regarding the NYSE's proposed corporate governance changes, please contact the author of this Securities Update, Laura D. Richman, at +1 312 701 7304, or any of the lawyers listed below or any other member of our Corporate & Securities group.

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