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SEC APPROVES NYSE AND NASDAQ RULES REQUIRING SHAREHOLDER APPROVAL OF EQUITY COMPENSATION PLANS

By Kelly C. Simoneaux and Margaret F. Murphy

On June 30, 2003, the SEC approved rules previously proposed and adopted by the New York Stock Exchange and the Nasdaq Stock Market expanding the requirements for shareholder approval of equity compensation plans of listed companies. The SEC also approved a NYSE rule amendment that prohibits brokers from voting for or against equity compensation plans unless the broker has received instructions from the beneficial owner of the securities. *(Click here to link to the SEC's release approving the NYSE and Nasdaq rules on shareholder approval of equity compensation plans.)*

In general, the rules require shareholder approval of all equity compensation plans and arrangements and material revisions to existing equity compensation plans and arrangements adopted on or after June 30, 2003. Highlights of the new rules are discussed below.

Covered Plans

Both the NYSE and Nasdaq rules cover plans or arrangements that provide for the delivery of equity securities as compensation for services. The shareholder approval requirements do not apply to the following:

- inducement awards to new employees, although the NYSE requires the issuance of a press release;
- certain awards in connection with mergers and acquisitions;
- certain plans intended to meet the requirements of Internal Revenue Code Sections 401(a) (ESOPs and 401(k) plans) and 423 (employee stock purchase plans), as well as parallel excess plans that meet certain requirements; and
- plans where employees pay full current market value for shares.

The rules require that plans and amendments not required to be approved by shareholders be approved by the compensation committee of the board of directors or a majority of its independent directors. Plan amendments may be necessary to reflect these additional requirements. In addition, notification to the NYSE or Nasdaq is required.

The rules also provide that a plan that is silent on the repricing of stock options will be treated as prohibiting repricing.

Material Revisions

Shareholder approval is also required for material revisions to a plan or arrangement, including but not limited to:

- a material increase in the number of shares available under the plan;
- an expansion of the types of awards under the plan;
- a material expansion of the class of persons eligible to participate in the plan;
- a material change in the method of determining the strike price under the plan; and
- the deletion or limitation of a provision prohibiting repricing.

Treatment of Pre-Existing Plans

NYSE

Generally, under the NYSE's new rules, a plan adopted prior to June 30, 2003 will not be subject to the new shareholder approval requirements unless and until it is materially revised. However, grants under the following types of plans may only be made for a limited transition period:

- a plan containing a formula for automatic increases in the shares available or for automatic grants pursuant to a formula that either has not been previously approved by shareholders or does not have a term of ten years or less; or
- a plan that contains no limit on the number of shares that may be granted, whether or not approved by shareholders, and all grants must be consistent with past practice.

The limited transition period ends at the earliest to occur of: (i) the company's next annual meeting occurring after December 27, 2003, (ii) June 30, 2004, or (iii) the expiration of the plan.

Nasdaq

Under Nasdaq's new rules, a plan existing on June 30, 2003 will not be subject to the new shareholder approval requirements unless and until such plan is materially modified.

Prohibition on Discretionary Voting by Brokers

The new NYSE rules also prohibit a broker from voting on equity compensation plan matters unless the beneficial owner has given voting instructions, thus eliminating discretionary voting on these issues. This rule affects all brokers that are members of the NYSE, and thus will apply to the voting of all securities, whether listed on the NYSE or on Nasdaq, that are held in street name by NYSE brokers. This rule is effective for any meeting of shareholders held on or after September 28, 2003.

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U.S. DEPARTMENT OF LABOR ADOPTS INTERIM FINAL RULE IMPLEMENTING WHISTLEBLOWER PROTECTION PROVISIONS OF SARBANES-OXLEY ACT

By Sidney F. Lewis, V

On May 28, 2003, the U.S. Department of Labor ("DOL") adopted an interim final rule protecting the employees of publicly traded companies who are retaliated against for blowing the whistle on corporate securities fraud or other securities violations. Specifically, the provisions state that no publicly traded company may “discharge, demote, suspend, threaten, harass or in any manner discriminate against an employee” who legally provides information about what that employee “reasonably believes” is a securities law violation to a federal agency, Congress, or the employee’s supervisor. Employees who allege they are retaliated against may file a complaint with the U.S. Secretary of Labor for remedies including reinstatement, back pay with interest, and compensation for any “special damages sustained as a result of the discrimination, including litigation costs, expert witness fees and attorney’s fees.”

In order for the whistleblower protection provisions to apply, the complaining employee must report conduct that the employee reasonably believes is a securities law violation. A question for litigation would be whether such a belief is reasonable.

Employees must file their complaints within 90 days of the date the alleged violation occurs. The date of the violation is defined as the date the discriminatory decision has been both made and communicated to the employee. The limitations period commences once the employee is “aware or reasonably should have been aware of the employer’s decision.” Investigations will be conducted by the Occupational Safety and Health Administration (“OSHA”). Employers or persons named in the complaint will be notified regarding the allegations made, the substance of the evidence presented in the complaint (redacted to protect the identify of any confidential informants), and the rights of the named person. OSHA will also provide a copy of the notification to the SEC.

The complaining employee must make a *prima facie* case that the prohibited behavior was a contributing factor in the adverse action complained of. Otherwise, the agency will terminate the investigation and dismiss the complaint. Under this standard, the complaining employee must show that:

- the employee engaged in a protected activity or conduct;
- the named person knew or suspected, actually or constructively, that the employee engaged in the protected activity;
- the employee suffered an unfavorable personnel action; and
- the circumstances were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action.

The DOL's interim rule states that a complainant will "normally" satisfy this burden by showing that the adverse personnel action took place shortly after the whistleblowing conduct.

The defending person has to demonstrate by clear and convincing evidence that the same personnel action would have taken place in the absence of the whistleblowing conduct. It must present this evidence in writing within 20 days of notice from OSHA that evidence is being requested. The named person may also request a meeting with the OSHA Assistant Secretary within this 20-day period to present its position.

Within 60 days of the filing of the complaint, the OSHA Assistant Secretary will issue written findings as to whether or not there exists reasonable cause to believe that the named person has discriminated against the complainant. If the Assistant Secretary finds that reasonable cause exists, a preliminary order will be issued that will include all relief necessary to make the employee whole, including reinstatement, back pay, and special damages. The preliminary order will become final within 30 days unless any party seeks judicial review of the order by an administrative law judge by filing objections to the findings and preliminary order and a written request for a hearing.

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SEC STAFF ISSUES REPORT REGARDING PROXY PROCESS REFORM

By Richard P. Wolfe and Amos J. Oelking, III

On July 15, 2003, the staff of the SEC's Division of Corporation Finance, in response to a directive from the SEC, issued a report discussing alternatives for increasing shareholder participation in the proxy process, including the nomination and election of directors. *(Click here to link to the full text of the Division of Corporation Finance's report.)*

The Division's recommendations set forth in the report include:

- enhanced disclosure in proxy materials regarding the company's director nomination process, including:
  - how shareholders can recommend a nominee; and
  - if the company has a nominating committee, the committee's procedures and criteria for developing and considering nominees and for screening director candidates, the source of the board's nominees, the qualifications the committee believes directors should have, and, if the committee chooses not to nominate a candidate recommended by a significant, long-term shareholder, the reasons for the committee's decision.
- enhanced disclosure in proxy materials regarding shareholder communications with the company's directors, including:
  - how shareholders can communicate with the company's board;
  - the number of times individual directors met with shareholders in the prior year; and
  - any action taken by the board as a result of its communications with shareholders.
- new proxy rules that would allow shareholders to include their director nominees in the company's proxy materials, provided:

- there has been one or more "triggering events" indicating that shareholders may not have had an adequate voice in the company's proxy process (*e.g.,* where a shareholder proposal included in a prior proxy statement was approved by the company's shareholders but not acted upon by the company);

- neither the nomination nor election of the nominee violates federal or applicable state law or any applicable listing standards;

- the shareholder nominees meet appropriate independence criteria;

- the number of candidates shareholders may nominate is limited; and

- there are minimum standards with respect to the holdings of nominating shareholders.

* * * * *

On August 6, 2003, in response to the Division's recommendations, the SEC voted to propose rule changes to require enhanced disclosure in proxy materials regarding the director nomination process and shareholder communications with directors. The SEC will issue a formal proposal within the next several days, which will be the subject of a Jones Walker E*Zine.

The SEC expects to consider the Division's recommendations regarding enhanced shareholder access to proxy materials later this Fall.

Please remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues you may contact the head of our Corporate and Securities practice group:

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