

Client Alert

A report
for clients
and friends
of the firm **December 2003**

Amended NASDAQ Stock Market Listing Standards

Introduction

On November 4, 2003, the Securities and Exchange Commission ("SEC") approved certain amendments to the listing standards of the Nasdaq Stock Market, Inc. ("Nasdaq"). The amended listing standards (the "Revised Standards"), together with the recently enacted Sarbanes-Oxley Act of 2002 and the new and proposed SEC regulations, represent a comprehensive realignment of minimum governance standards for Nasdaq-listed companies ("Companies"). This Client Alert outlines the major requirements set forth in the Revised Standards. A summary of some of the most important provisions are as follows:

- A majority of a Company's board of directors must be "independent";
- Independent directors must have regularly scheduled executive sessions;
- Companies must establish audit committees composed entirely of independent directors who are financially literate (with at least one member who has experience in finance or accounting resulting in financial sophistication) and have written charters addressing specific purposes, duties and responsibilities and annual performance evaluations;
- Nominations of directors must be selected or recommended to the board for selection, by a majority of independent directors or by a nominations committee comprised solely of independent directors;

- Compensation of officers must be determined or recommended to the board for determination by a majority of independent directors or by a compensation committee comprised solely of independent directors;
- All related party transactions must be approved by the audit committee or another independent body of directors; and
- Companies must adopt a code of conduct.

Effective Dates

Non-Classified Board of Directors

A Company with a board of directors that is not classified will have until the earlier of (i) the first annual meeting of shareholders after January 15, 2004 or (ii) October 31, 2004 (the earlier of such dates being referred to hereinafter as the "Compliance Date") to comply with the Revised Standards except for those requirements pertaining to the code of conduct and related party transactions described below.

Classified Board of Directors

A Company with a classified board of directors that would be required to change a director who would not normally stand for election in the first annual meeting of shareholders after January 15, 2004 may continue such directors in office until the second annual meeting after the Compliance Date, but no later than December 31, 2005.

Majority of Independent Directors

General Rule

The Revised Standards require a Company to have a majority independent directors on its board of directors.

Definition of Independent Director

An independent director is any person other than an officer or employee of the Company or its subsidiaries or any other individual having a relationship, which, in the opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.¹

Conflicted Relationships

The following are conclusively presumed to lack independence under the Revised Standards:²

- a director who is employed by the Company or by any parent or subsidiary of the Company;
- a director who has accepted or has a Family Member³ who has accepted any payments from the Company or any parent or subsidiary of the Company in excess of \$60,000 annually;⁴
- a director who is a Family Member of an individual who is employed by the Company or by any parent or subsidiary of the Company as an executive officer;
- a director who is, or has a Family Member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the Company made, or from which the Company received, payments for property or services in that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is greater;⁵
- a director of the Company who is, or has a Family Member who is, employed as an executive officer of another entity where any of the executive officers of the Company serve on the compensation committee of such other entity; or
- a director who is, or has a Family Member who is, a current partner of the Company's outside auditor, or was a partner or employee of the Company's outside auditors who worked on the Company's audit.

Look-Back Period. The disqualifying circumstances described above are subject to a three year look-back period that commences on the date the relationship ceases. For example, a director employed by the Company is not independent until three years after such employment terminates.

Non-Compliance

The Company must disclose in its public filings those directors that the board has determined to be independent. If a Company fails to comply with the requirement above due to one vacancy, or one director ceases to be independent due to circumstances beyond their reasonable control, the Company must regain compliance with the requirement by the earlier of its next annual shareholder meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. A Company relying on this provision must provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

Mandatory Executive Sessions

The independent directors must have regularly scheduled executive sessions at which only the independent directors are present. Such executive sessions should occur at least twice a year, and perhaps more frequently, in conjunction with regularly scheduled board meetings.

Audit Committee

The following requirements are in addition to any other requirements of audit committees under the Securities Exchange Act of 1934 (the "Exchange Act").

Composition

Each Company must have an audit committee comprised of at least three members, each of whom:

- must be an independent director;⁶
- must not accept directly or indirectly any consulting, advisory or other compensatory fee from the Company or any subsidiary;

1 Ownership of Company stock by itself does not preclude a board finding of independence. However, shareholding will be relevant to determine a person's status as an "affiliated person" for purposes of applying the independence requirement of the Securities Exchange Act of 1934 applicable to audit committee membership.

2 In the case of an investment company, a director who is an "interested person" of the investment company as defined in the Investment Company Act of 1940 will be presumed to lack independence.

3 Family Member means "a person's spouse, parents, children and siblings, whether by blood or by marriage, adoption or anyone residing in such person's home."

4 Other than compensation for board or committee service; payments arising solely from investments in the Company's securities; compensation paid to a Family Member who is non-executive employee of the Company or a parent or subsidiary of the Company; benefits under a tax-qualified retirement plan or non-discretionary compensation; or loans permitted under Section 13(k) of the Securities Exchange Act of 1934.

5 Other than payments arising solely from investments in the Company's securities; or payments under non-discretionary charitable contribution matching programs.

6 If the committee is comprised of at least three members, an exception to the independence requirement will be available for one non-independent director who is not a current officer or employee (or a Family Member of an officer or employee) if the board, under exceptional and limited circumstances, determines that his or her membership is in the best interests of the Company and its shareholders and discloses the nature of the relationship and the reasons for its determination in the Company's public filings. Any member appointed under this exception may serve for up to two years and cannot chair the committee.

- must not be an affiliated person (as defined in the Exchange Act) of the Company or any subsidiary;
- must not have participated in the preparation of the financial statements of the Company or any current subsidiary of the Company at any time during the past three years; and
- must be able to read and understand financial statements as of the date he or she joins the committee.

In addition, each Company must certify that it has, and will continue to have, at least one member of the audit committee who has had past employment and experience in finance or accounting which results in the individual's financial sophistication.

Written Charter

The audit committee must have a written charter that specifies:

- the scope of the committee's responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements;
- the committee's responsibility for:
 - ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the Company;
 - actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor; and
 - taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor.
- the committee's purpose of overseeing the accounting and financial reporting processes of the Company and the audits of its financial statements; and
- that the committee has the authority to comply with the SEC's rules under the Exchange Act with respect to:
 - registered public accounting firms;
 - complaints relating to accounting, internal accounting controls or auditing matters;

- authority to engage advisors; and
- funding as determined by the audit committee.⁷

Charter Certification

Each Company must certify that it has adopted a formal written audit committee charter and that the audit committee has reviewed and reassesses the adequacy of the charter on an annual basis.

Notice of Non-Compliance

- If a Company fails to comply with the audit committee composition requirements because an audit committee member ceases to be independent for reasons outside the member's reasonable control, the audit committee member may remain on the audit committee until the earlier of (i) the Company's next annual shareholders meeting or (ii) one year from the occurrence of the event that caused the failure to comply with the requirement. A Company relying on this provision must give notice to Nasdaq immediately upon learning the event or circumstance that caused the non-compliance.
- If a Company fails to comply with the audit committee composition requirements due to one vacancy on the audit committee and the exception described above is not being relied upon for another member, the Company will have until the earlier of (i) the next annual shareholders meeting or (ii) one year from the occurrence of the event that caused the failure to comply with this requirement. A Company relying on this provision must provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

Nominations of Directors

Process for Nomination

The nomination of directors must be selected, or recommended for the board's selection, by:

- a majority of the independent directors; or
- by a nominations committee comprised solely of independent directors.⁸

Certification

Each Company must certify that it has adopted a formal written charter or board resolution, as applicable, addressing the

⁷ Audit committees for investment companies must also establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.

⁸ If the committee is comprised of at least three members, an exception to the independence requirement will be available for one non-independent director who is not a current officer or employee (or a Family Member of an officer or employee) if the board, under exceptional and limited circumstances, determines that his or her membership is in the best interests of the Company and its shareholders and discloses the nature of the relationship and the reasons for its determination in the Company's public filings. Any member appointed under this exception may serve for up to two years.

nomination process and such related matters as may be required under federal securities laws.

Inconsistent Nominating Structure

If the Company is subject to a binding contractual or other obligation that requires a director nomination structure inconsistent with the above requirements, and such obligation pre-dates November 4, 2003, then the nomination of such directors will not be subject to the above requirements.

Compensation of Executive Officers

The compensation of the CEO and other executive officers of a Company may be determined, or recommended to the board for determination, by:

- a majority of the independent directors; or
- by a compensation committee comprised solely of independent directors.⁹

When determining the CEO's compensation, the CEO may not be present during the voting or the deliberations.

Code of Conduct

A Company must adopt a code or codes of conduct applicable to all directors, officers and employees.¹⁰

Required Matters to Be Addressed

The code of conduct must:

- comply with the definition of a "code of ethics" set out in the Sarbanes-Oxley Act of 2002;
- comply with any regulations promulgated thereunder by the SEC; and
- provide for an enforcement mechanism which includes:
 - a mechanism that ensures prompt and consistent enforcement of the code;
 - protection for persons reporting questionable behavior;
 - clear and objective standards for compliance; and
 - a fair process by which to determine violations.

Public Disclosure

The code of conduct must be publicly available. Any waivers of the code for directors or executive officers must be approved by the board and must be disclosed in the Company's public filings within five days together with the reasons for the waiver.

Effective Date

Companies must adopt a code of conduct by May 4, 2004.

Notice of Non-Compliance

A Company must provide Nasdaq with prompt notification after an executive officer of the Company becomes aware of any material noncompliance with the Revised Standards.

Foreign Private Issuers

General Exemption

A foreign private issuer listed on Nasdaq may obtain exemptions from Nasdaq's corporate governance standards if such rules would require the Company to do anything contrary to the laws, rules, regulations or generally accepted business practices of its home country.

Public Disclosure of Exemption

A foreign Company must disclose the receipt of each corporate governance exemption in its public filings. The disclosure should include a brief statement of the Company's home country practice and what alternative measures, if any, the Company has taken in lieu of the corporate governance requirements from which it was exempted.

Effective Date of Compliance

For foreign private issuers, the Revised Standards (except for those requirements pertaining to the code of conduct and related party transactions) must be implemented by July 31, 2005.

Small Business Issuers¹¹

For small business issuers, the Revised Standards (except for those requirements pertaining to the code of conduct and related party transactions) must be implemented by July 31, 2005.

⁹ If the committee is comprised of at least three members, an exception to the independence requirement will be available for one non-independent director who is not a current officer or employee (or a Family Member of an officer or employee) if the board, under exceptional and limited circumstances, determines that his or her membership is in the best interests of the Company and its shareholders and discloses the nature of the relationship and the reasons for its determination in the Company's public filings. Any member appointed under this exception may serve for up to two years.

¹⁰ Companies can satisfy this obligation by adopting one or more codes of conduct that satisfy the definition of "code of ethics" set out in the Sarbanes-Oxley Act of 2002.

¹¹ A "small business issuer" is any an entity that: (i) has revenues of less than \$25,000,000; (ii) is a U.S. or Canadian issuer; (iii) is not an investment company; (iv) if a majority owned subsidiary, the parent corporation is also a small business issuer; and (v) does not have a public float of \$25,000,000 or more.

Related Party Transactions

Effective January 15, 2004, each Company must conduct an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis, and all such transactions must be approved by the Company's audit committee or another independent body of the board.

Controlled Company Exemption

Definition

A Controlled Company is a company of which more than 50% of the voting power is held by an individual, group or another company.

Exemptions

A Controlled Company is not required to have a majority of independent directors or to comply with the rules described above regarding nominations and compensation committees. However, Controlled Companies must hold regular executive sessions of independent directors and comply with the audit committee requirements.

Public Disclosure

A Controlled Company relying on the above exemption must disclose in its public filings that it is a Controlled Company and the basis for that determination.

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Client Alert

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