

employees) who shares such person's home." The Commission's proposal includes only a person's spouse, minor children or stepchildren or children or stepchildren sharing the director's home.

## 2. Statutory Basis

The Exchange believes that the basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)<sup>11</sup> that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*<sup>12</sup>

#### Overview

**Widespread Support for the Recommendations.** The Exchange indicates that the vast majority of commentators, including listed companies, institutional investors, and other interested organizations and individuals enthusiastically embraced the Committee's recommendations for new corporate governance and listing standards for the NYSE.

**Concerns of Smaller Companies.** While most large companies, law firms and institutions expressed general support for the proposals, commentators who characterized themselves as smaller businesses voiced concern. All of these companies complained that the recommendations seem to have been structured for a large-company model, without taking into account the disproportionate impact the proposed rules would have on smaller companies. In particular, they argued that the Committee's recommendations for separate nominating and compensation committees, together with its requirement of majority-independent boards, combined to effectively require that smaller companies enlarge their

relatively small boards. These constituents were particularly concerned with the increased costs that compliance with the recommendations would entail. They argued that this would cause the diversion of shareholder value to unrelated third parties and the misdirection of board and management time and effort from productive to bureaucratic activities.

**Difficulty of Obtaining Independent Directors.** Several large companies expressed concern that the new rules would make it more difficult for companies to find quality independent directors because of the increased responsibilities and time commitment that the rules would require of independent directors (especially audit committee members), as well as a perceived increase in such directors' exposure to liability.

#### Majority-Independent Boards

Many commentators applauded the recommendation that listed companies be required to maintain majority-independent boards. However, numerous constituents, large and small, raised concerns that the requirement would have a variety of adverse consequences.

#### (a) Controlled Companies

Most prominently, more than half of the commenting companies noted that the majority-independent board requirement would create insuperable difficulties for companies controlled by a shareholder or parent company. They argued that the rule would be inequitable as applied to them in that it would deprive a majority holder of its shareholder rights; unnecessary in that the Committee's other recommendations (in particular the independent committee and disclosure requirements) would adequately protect minority shareholders; and undesirable in that it would reduce access to capital markets by discouraging spin-offs, by inducing some currently public companies to go private rather than lose control of their subsidiary, and by discouraging those who manage buyout funds and venture capital funds from using initial public offerings and NYSE listings as a means for achieving liquidity and raising capital. One company argued that the majority-independent board requirement would vitiate the ability of a parent to effectively manage its subsidiary, in the process denying to shareholders of the parent the benefits associated with its controlling stake in the subsidiary and requiring them instead to transfer control of the subsidiary to third parties.

Similarly, commentators suggested that companies that are majority-owned by officers and directors should be exempt from this recommendation. One such company argued that where corporate insiders own a majority of the stock of a company, the interests of outside minority shareholders can be adequately protected by the proposed requirement of an independent compensation committee. Family-owned companies also expressed concern with the majority-independence requirement because the proposal would limit the families' involvement with the board.

The provision in subsection 1 of Section 303A exempting controlled companies from the requirements to have a majority independent board and independent nominating and compensation committees is intended to address these concerns.

#### (b) Shareholder Agreements and Multiple Classes of Stock

Companies with multiple classes of securities, some of which have a right of representation on the board, argued that they should not have to meet the majority-independence requirement because doing so would be in direct conflict with their equity structure and the shareholder rights embedded therein.

Companies with multiple classes of stock representing different constituencies also had difficulty with this recommendation. One company that recently gave organized labor the right to appoint a director to the board as part of a collective bargaining agreement requested that the NYSE allow grandfathering of such arrangements. This company noted that compliance with this recommendation would effect a retroactive change in the bargains that brought about these arrangements and might trigger stockholder approval requirements.

The Exchange clarified in subsection 4 of Section 303A that the selection and nomination of such directors need not be subject to the nominating committee process.

#### Tighter "Independent Director" Definition

Most commentators were in favor of tightening the definition of "independence," with only a quarter advocating the continued use of existing standards. Certain institutional investors praised with particular emphasis the five-year look-back on compensation committee interlocks. However, commentators have raised several general questions, described below, as well as numerous specific

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> For a discussion of comments received with respect to NYSE's proposal regarding shareholder approval of equity-compensation plans which was filed as a separate proposal, see Securities Exchange Act Release No. 46620 (October 8, 2002), 67 FR 63486 (October 11, 2002) (SR-NYSE-2002-46).