

approves the NYSE proposal, as amended by NYSE Amendments No. 1 and 2, and the Nasdaq proposal, as amended by Nasdaq Amendments No. 1, 2, and 3. The Commission has found good cause to grant accelerated approval to NYSE Amendments No. 1 and 2 and Nasdaq Amendments No. 2 and 3, as discussed below, and is soliciting comments from interested persons on these amendments.

II. Description of the NYSE and Nasdaq Proposals

A. NYSE Proposal

The NYSE proposes to adopt new section 303A(8) of the NYSE's Listed Company Manual, which would require shareholder approval of all equity-compensation plans and material revisions to such plans, subject to limited exemptions.¹² This new rule, when approved by the Commission, will replace the NYSE's current pilot program relating to amendments to Sections 312.01, 312.03 and 312.04 of the NYSE's Listed Company Manual with respect to the definition of a "broadly-based" stock option plan.¹³

Under the NYSE proposal, as amended, an equity compensation plan is defined as a plan or other arrangement that provides for the delivery of equity securities (either newly issued or treasury shares) of the listed company to any employee, director or other service provider as compensation for services, including a

compensatory grant of options or other equity securities that is not made under a plan. The NYSE has also proposed changes to clarify certain plans that would not be considered equity compensation plans under its definition.¹⁴ In addition, the NYSE proposal provides for certain types of grants that are exempted from shareholder approval. These limited exemptions include: (1) Inducement awards to person's first becoming an employee of the issuer or any of its subsidiaries; (2) mergers and acquisitions, when conversions, replacements or adjustments of outstanding options or other equity compensation awards are necessary to reflect the transaction, and when shares available under certain plans acquired in corporate acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval; and (3) plans intended to meet the requirements of section 401(a) of the Internal Revenue Code¹⁵ (e.g., ESOPs), plans intended to meet the requirements of section 423 of the Internal Revenue Code,¹⁶ and parallel excess plans. The NYSE also proposes that, in circumstances in which equity compensation plans and amendments to plans are not subject to shareholder approval, the plans and amendments still must be subject to the approval of the company's compensation committee or a majority of the company's independent directors. Finally, in its proposal, the NYSE provides a non-exclusive list of "material revisions" to a plan that would require shareholder approval, and also clarifies when plans containing an "evergreen formula" and when the "repricings" of options in plans would require shareholder approval.¹⁷

The NYSE also proposes to amend NYSE Rule 452 to prohibit member organizations from voting on equity compensation plans unless the beneficial owner of the shares has given voting instructions. In addition, the NYSE proposes to make conforming changes to current Sections 303.00, 312.03, 312.04, and 402.08 of the NYSE's Listed Company Manual.

NYSE Amendment No. 2 to the NYSE filing proposes a number of changes to the rules as they were published in the Notice of the NYSE Proposal. According to the NYSE, these changes were made in response to the comment letters and

discussions with Commission staff. As a general matter, the changes provide additional guidance as to the scope of the NYSE's proposed rule changes, including the type of material changes to a plan that must be submitted for shareholder approval. The NYSE also proposes to include a new section entitled "Transition Rules" to clarify when shareholder approval will be required for plans adopted before the effective date of the proposed amendments. The basic structure of the rule as proposed has remained the same as originally submitted. While the Notice of the NYSE Proposal reflects the original format of the recommendations made by the Committee, stating a basic principle and including additional explanation and commentary, the NYSE states that it intended, through the proposed amendments to the rule text of section 303A(8) in NYSE Amendment No. 2 to write the rule language in a more "plain-English" format to enhance understanding of the rule.

1. Significant Changes From the Original Filing of the NYSE Proposal

The NYSE proposes to clarify the description of plans that are not equity compensation plans to expressly exclude plans that do not provide for delivery of equity securities of the issuer (e.g., plans that pay in cash), and deferred compensation plans under which employees pay full current market value for deferred shares.

The NYSE proposes to modify the language of the rule to clarify that shareholder approval is required for pre-existing plans that were not approved by shareholders and that have neither an evergreen formula nor a specific number of shares available under the plan. However, the NYSE proposes to provide a transition period for requiring shareholder approval for such plans.¹⁸ In addition, the NYSE has specified that, during the period prior to approval, the plan may be utilized, but only in a manner consistent with past practice.

In the section entitled "Material Revisions," the NYSE proposes to more specifically define the concept of "evergreen" plans (i.e., that contain a formula for automatic increases in the shares available) or "formula" plans¹⁹ (i.e., plans that provide for automatic grants pursuant to a formula), and proposes to introduce the concept of "discretionary plans." Generally, a

Nasdaq Amendment No. 3, Nasdaq did the following: (1) Replaced Nasdaq Amendment No. 2 in its entirety; (2) stated that on November 14, 2002, the Nasdaq Board of Directors approved, and that on December 9, 2002, the Board of Governors of the NASD reviewed, all remaining aspects of the Nasdaq proposal; and (3) made clarifying and conforming changes to the Nasdaq proposal in response to discussions with Commission staff and in response to the comment letters. As discussed below, Nasdaq Amendment No. 3, among other things, also clarified the term "material amendment," proposed an exception to shareholder approval for plans that provide a way to purchase shares on the open market or from the issuer at fair market value, and discussed evergreen plans and repricings. For a more detailed description of Nasdaq Amendment No. 3, see Section II.B., *infra*.

¹² The NYSE proposal is part of the recommendations made by the NYSE's Corporate Accountability and Listing Standards Committee ("Committee"), a committee appointed by NYSE to review its corporate governance listing standards. The rest of the Committee's recommendations are in a separate rule filing, File No. SR-NYSE-2002-33. See Securities Exchange Act Release No. 47672, 68 FR 19051 (April 17, 2003) (published notice of SR-NYSE-2002-33).

¹³ See Securities Exchange Act Release No. 41479 (June 4, 1999), 64 FR 31667 (June 11, 1999) (notice of filing and order granting accelerated approval, on a pilot basis, to File No. SR-NYSE-98-32). The Pilot was extended several times, most recently until June 30, 2003. See Securities Exchange Act Release No. 47409 (February 26, 2003), 68 FR 10560 (March 5, 2003) (File No. SR-NYSE-2003-04).

¹⁴ See NYSE Amendment No. 2, *supra* note 6. See also Section II.A.1. and 2., *infra*.

¹⁵ 26 U.S.C. 401(a).

¹⁶ 26 U.S.C. 423.

¹⁷ See NYSE Amendment No. 2, *supra* note 6. See also Section II.A.1. and 2., *infra*.

¹⁸ See Section II.A.2., *infra*.

¹⁹ Under the NYSE's rules, an increase or grant pursuant to an evergreen or formula plans would require shareholder approval for each increase or grant unless the plan has a term of not more than 10 years.