

of a public offering) or the sale of stock to such person who has borrowed money from the company, will normally necessitate shareholder approval.]

Commentary \* \* \*

.01 Section 711 requires shareholder approval when a plan or other equity compensation arrangement is established or materially amended. For these purposes, a material amendment would include, but not be limited to, the following:

(a) any material increase in the number of shares to be issued under the plan (other than to reflect a reorganization, stock split, merger, spinoff or similar transaction);

(b) any material increase in benefits to participants, including any material change to: (i) permit a repricing (or decrease in exercise price) of outstanding options, (ii) reduce the price at which shares or options to purchase shares may be offered, or (iii) extend the duration of a plan;

(c) any material expansion of the class of participants eligible to participate in the plan; and

(d) any expansion in the types of options or awards provided under the plan.

While general authority to amend a plan would not obviate the need for shareholder approval, if a plan permits a specific action without further shareholder approval, then no such approval would generally be required. However, if a plan contains a formula for automatic increases in the shares available (sometimes called an "evergreen formula"), or for automatic grants pursuant to a dollar-based formula (such as annual grants based on a certain dollar value, or matching contributions based upon the amount of compensation the participant elects to defer), such plans cannot have a term in excess of ten years unless shareholder approval is obtained every ten years. Plans that do not contain a formula and do not impose a limit on the number of shares available for grant would require shareholder approval of each grant under the plan. A requirement that grants be made out of treasury shares or repurchased shares will not alleviate these additional shareholder approval requirements.

As a general matter, when preparing plans and presenting them for shareholder approval, issuers should strive to make plan terms easy to understand. In that regard, it is recommended that plans meant to permit repricing use explicit terminology to make this clear.

Section 711 provides an exception to the requirement for shareholder

approval for shareholder approval for warrants or rights offered generally to all shareholders. In addition, an exception is provided for tax qualified, non-discriminatory employee benefit plans as well as parallel nonqualified plans<sup>1</sup> as these plans are regulated under the Internal Revenue Code and Treasury Department regulations. An equity compensation plan that provides non-U.S. employees with substantially the same benefits as a comparable tax-qualified, non-discriminatory employee benefit plan or parallel nonqualified plan that the issuer provides to its U.S. employees, but for features necessary to comply with applicable foreign tax law, is also exempt from shareholder approval under this section.

Further, there is an exception for inducement grants to new employees because in these cases a company has an arm's length relationship with the new employees. Inducement grants for these purposes include grants of options or stock to new employees in connection with a merger or acquisition. Section 711 requires that such issuances must be approved by the issuer's independent compensation committee or a majority of the issuer's independent directors. Also, promptly following an issuance of any employment inducement grant in reliance on this exception, the listed company must disclose in a press release the material terms of the grant, including the recipient(s) of the grant and the number of shares involved.

In addition, plans or arrangements involving a merger or acquisition do not require shareholder approval in two situations. First, shareholder approval will not be required to convert, replace or adjust outstanding options or other equity compensation awards to reflect the transaction. Second, shares available under certain plans acquired in acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval. This exception applies to situations where the party which is not a listed company following the transaction has shares available for grant under pre-existing plans that meet the requirements of this Section 711. These shares may be used for post-transaction grants of options and other equity awards by the listed company (after appropriate adjustment of the number of shares to reflect the transaction), either under the pre-existing plan or arrangement or another plan or arrangement, without further shareholder approval, provided: (1) The time during which those shares are available for grants is not extended beyond the period when they would have been available under the pre-

existing plan, absent the transaction, and (2) such options and other awards are not granted to individuals who were employed by the granting company or its subsidiaries at the time the merger or acquisition was consummated. A plan or arrangement adopted in contemplation of the merger or acquisition transaction would not be viewed as pre-existing for purposes of this exception. This exception is appropriate because it will not result in any increase in the aggregate potential dilution of the combined enterprise. In this regard, any additional shares available for issuance under a plan or arrangement acquired in connection with a merger or acquisition would be counted in determining whether the transaction involved the issuance of 20% or more of the company's outstanding common stock, thus triggering the shareholder approval requirements of Section 712(b).

Inducement grants, tax qualified non-discriminatory benefit plans, and parallel nonqualified plans are subject to approval by either the issuer's independent compensation committee, or a majority of the issuer's independent directors. A listed company is not permitted to use repurchased shares to fund option plans or grants without prior shareholder approval. In addition, the issuer must notify the Exchange in writing when it uses any of these exceptions (see also Part 3 with respect to the requirements applicable to additional listing of the underlying shares).

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<sup>1</sup> The term "parallel nonqualified plan" means a plan that is a "pension plan" within the meaning of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1002 (1999), that is designed to work in parallel with a plan intended to be qualified under Internal Revenue Code Section 401(a), to provide benefits that exceed the limits set forth in Internal Revenue Code Section 402(g) (the section that limits an employee's annual pre-tax contributions to a 401(k) plan), Internal Revenue Code Section 401(a)(17) (the section that limits the amount of an employee's compensation that can be taken into account for plan purposes) and/or Internal Revenue Code Section 415 (the section that limits the contributions and benefits under qualified plans) and/or any successor or similar limitations that may thereafter be enacted. However, a plan will not be considered a parallel nonqualified plan unless (i) it covers all or substantially all employees of an employer who are participants in the related qualified plan whose annual compensation is in excess of the limit of Code Section 401(a)(17) (or any successor or similar limitation that may hereafter be enacted) and (ii) its terms are substantially the same as the qualified plan that it parallels except for the elimination of