

after a bona fide period of interruption of employment, and to new employees in connection with an acquisition or merger. The Commission believes that these limitations should help to prevent the inducement exception from being used inappropriately.

The Commission notes that the Exchange is proposing to include a requirement, similar to the requirement under the NYSE and Nasdaq's recently approved shareholder approval rules, that, promptly following the grant of any inducement award, companies must disclose in a press release the material terms of the award, including the recipient(s) of the award and the number of shares involved.<sup>12</sup> The Commission notes that the Exchange is also proposing a requirement, similar to the requirements under the NYSE and Nasdaq's recently approved shareholder approval rules,<sup>13</sup> that an issuer must notify it in writing when it uses this exception, and/or any other exception, from its shareholder approval requirement. The Commission believes that these disclosure and notification requirements will provide transparency to investors and should reduce the potential for abuse of this exception for inducement grants.

#### *B. Exception From Shareholder Approval for Mergers and Acquisitions*

The Commission notes that the Exchange's exception from shareholder approval for mergers and acquisitions contains safeguards that should prevent abuse in this area. First, only pre-existing plans that were previously approved by the acquired company's shareholders would be available to the listed company for post-transactional grants. In addition, shares under those previously approved plans could not be granted to individuals who were employed, immediately before the transaction, by the post-transaction listed company or its subsidiaries. The Commission also notes that, under the Exchange's proposal, any shares reserved for listing in connection with

a merger or acquisition pursuant to this exception would be counted by the Exchange in determining whether the transaction involved the issuance of 20% or more of the company's outstanding common stock, thereby requiring shareholder approval under Phlx Rule 850(c). Finally, the Commission notes that the Exchange proposes an additional requirement that an issuer must notify it in writing when it uses this exception, and/or any other exception, from its shareholder approval requirement. Based on the above, the Commission believes that the Exchange has provided measures to ensure that the exception for mergers and acquisitions is only used in limited circumstances, which should help reduce the potential for dilution of shareholder interests.

#### *C. Exception From Shareholder Approval for Tax Qualified and Parallel Nonqualified Plans*

The Commission believes that, given the extensive government regulation—the Internal Revenue Code and Treasury regulations—for tax qualified plans and the general limitations associated with parallel nonqualified plans, shareholders should not experience significant dilution as a result of this exception. In addition, the Commission notes that the Exchange proposes to add a limitation under this exception that a plan would not be considered a nonqualified parallel plan under its proposal if employees who are participants in such a plan receive employer contributions under the plan in excess of 25% of the participants' cash compensation. The Commission further notes that the Exchange proposes an additional requirement that an issuer must notify it in writing when it uses this exception, and/or any other exception, from its shareholder approval requirement. The Commission believes that, taken together, these limitations should reduce concerns regarding abuse of this exception from the shareholder approval requirements.

In addition, the Commission notes that, similar to the exceptions in the NYSE and Nasdaq's recently approved shareholder approval rules, the Exchange proposes to adopt an exception from the shareholder approval requirements for 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. The Commission believes that this

change will conform the Exchange's shareholder approval rule to that of the NYSE and Nasdaq and will provide greater clarity for issuers regarding tax qualified, non-discriminatory employee benefit plans and parallel nonqualified plans for their non-U.S. employees.

#### *D. Material Amendments/Revisions to Plans*

The Commission notes that the Exchange proposes to provide a non-exclusive list, similar to lists found in the NYSE and Nasdaq's shareholder approval rules,<sup>14</sup> as to what constitutes a material amendment/revision to a plan. As noted above, material amendments/revisions to plans will require shareholder approval under Exchange rules. A material amendment/revision under the Exchange's proposal would include, but is not limited to: A 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); a material increase in benefits to participants, including any material change to (1) permit a repricing (or decrease in exercise price) of outstanding options, (2) reduce the price at which shares or options to purchase shares may be offered, or (3) extend the duration of the plan; a material expansion of the class of participants eligible to participate in the plan; and an expansion of the type of options or awards available under the plan. The Exchange's proposal also describes what would constitute a material amendment/revision for plans containing a formula for automatic increases (such as evergreen plans) and automatic grants requiring shareholder approval.

The Commission believes that the Exchange's non-exclusive list of what would constitute a material amendment/revision to a plan provides companies with clarity and guidance for when certain amendments and revisions to plans would require shareholder approval. The Commission also believes that the Exchange's proposal to conform its non-exclusive list with the NYSE and Nasdaq's rules on material amendments/revisions should help to ensure that the concept of material amendments/revisions is consistent among the markets so that differences between the markets cannot be abused.

#### *E. Repricing of Plans*

The Commission notes that, under the Exchange's proposal, if a plan is amended to permit repricing, such an amendment would be considered a

<sup>12</sup> This disclosure would, of course, be in addition to any information that is required to be disclosed in annual reports filed with the Commission. For example, item 201(d) of Regulation S-K [17 CFR 229.201(d)] and item 201(d) of Regulation S-B [17 CFR 228.201(d)] require issuers to present—in their annual reports on Form 10-K or Form 10-KSB—separate, tabular disclosure concerning equity compensation plans that have been approved by shareholders and equity compensation plans that have not been approved by shareholders.

<sup>13</sup> See Section 303A(8) of the NYSE's Listed Company Manual and NASD Rules 4310(c)(17)(A) and 4320(e)(15)(A). Under the Exchange's proposed rules, issuers have to notify the Exchange no later than 15 calendar days prior to the use of any exceptions from the shareholder approval requirement.

<sup>14</sup> See *supra* note 3; see also *supra* note 10.