

material amendment to a plan requiring shareholder approval. In addition, the Exchange recommended in its proposal that plans meant to permit repricing should explicitly and clearly state that repricing is permitted.

The Commission believes that the Exchange's proposal should benefit shareholders by ensuring that companies cannot do a repricing of options, which can have a dilutive effect on shares, without explicit shareholder approval of such provisions and their terms. The Commission also believes that the Exchange's approach to repricings is similar to the NYSE and Nasdaq's respective approaches to repricings, and should offer companies clarity and guidance as to when a change in a plan regarding the repricing of options would trigger a shareholder approval requirement.

F. Evergreen or Formula Plans and Plans Without a Formula or Limit on the Number of Shares Available

The Commission notes the Exchange's proposal provides guidance for the treatment of evergreen/formula plans. More specifically, under the Exchange's proposal, if a plan contains a formula for automatic increases in the shares available or for automatic grants pursuant to a formula, such plans cannot have a term in excess of ten years unless shareholder approval is obtained every ten years. In addition, under the Exchange's proposal, if a plan contains no limit on the number of shares available and is not a formula plan, then each grant under the plan will require separate shareholder approval. Furthermore, the Exchange's proposal provides that a requirement that grants be made out of treasury or repurchased shares will not alleviate the need for shareholder approval for additional grants.

The Commission believes that these provisions should help to ensure that certain terms of a plan cannot be drafted so broad as to avoid shareholder scrutiny and approval. The Commission also believes that the Exchange's proposed rules relating to the treatment of evergreen/formula plans and plans that do not contain a formula or place a limit on the number of shares available should provide more clarity and transparency to issuers as to when shareholder approval would be required for such plans. Finally, the Commission believes that the provision ensuring that treasury and repurchased shares cannot be used to avoid these additional shareholder approval requirements strengthens the proposal and ensures that companies cannot avoid compliance with the rule.

G. Miscellaneous Provisions

The Commission notes that the Exchange's proposal—similar to the NYSE and Nasdaq's recently approved shareholder approval rules¹⁵—incorporates the term “equity compensation” and proposes that plans that merely provide a convenient way to purchase shares in the open market or from the issuer at fair market price on equal terms to all security holders would not require shareholder approval. The Commission believes that the Exchange's proposal is consistent with the NYSE and Nasdaq's rules in this area and should provide greater clarity with respect to which plans would and would not require shareholder approval.

The Commission notes that the Exchange's proposal provides that pre-existing plans, which were adopted prior to the SEC's approval of the Exchange's proposal, would essentially be “grandfathered” and would not require shareholder approval unless the plans were materially amended. Under the Exchange's proposal, however, shareholder approval is required for each grant made pursuant to any pre-existing plans that were not approved by shareholders and that do not have an evergreen formula or a specific number of shares available under the plan. This is consistent with the NYSE, Nasdaq, and Amex shareholder approval rules on this matter. The Commission believes that this clarification should provide companies with guidance as to which plans would be subject to the Exchange's new shareholder approval requirements.

The Commission further notes that the Exchange proposes to adopt an exception from the shareholder approval requirement for warrants or rights offered generally to all shareholders. This exception would exclude stock purchase plans available on equal terms to all security holders of the company (e.g., a dividend reinvestment plan). The Commission believes that the adoption of such an exception would make the Exchange's proposal consistent with the rules of other markets in this area.

H. Elimination of Broker-Dealer Voting on Equity Compensation Plans

The Commission believes that the Exchange's proposed amendment to Phlx Rule 862 to preclude broker voting on equity compensation plans is consistent with the Act. The Commission notes that equity compensation plans have become an important issue for shareholders.

Because of the potential for dilution from issuances under such plans, shareholders should be making the determination rather than brokers on their behalf. The Commission further notes that NASD rules do not provide for broker voting on any matters and NYSE rules prohibit broker voting on equity compensation plans.¹⁶ Therefore, the Exchange's proposed provision would be consistent with NASD and NYSE rules regarding broker voting on equity compensation plans. The Commission has considered the impact on smaller issuers, such as those listed on Nasdaq and the Amex, in response to the comments on this issue.¹⁷ The Commission believes that the benefit of ensuring that the votes reflect the views of beneficial shareholders on equity compensation plans outweighs the potential difficulties in obtaining the vote.

The Commission also notes that the Exchange proposes to implement a transition period that would make the new rule eliminating broker voting on equity compensation plans applicable only to shareholder meetings that occur on or after the 90th day from the effective date of the Exchange's proposal.

I. Summary

Overall, the Commission believes that the Exchange's proposal is similar to the NYSE and Nasdaq's recently approved shareholder approval rules.¹⁸ The Commission therefore believes that the Exchange's proposal should provide for more clear and uniform standards for shareholder approval of equity compensation plans. The Commission notes that, even with the availability of the proposed limited exceptions from shareholder approval under the Exchange's proposal, shareholder approval under the new standards would be required in more circumstances than under existing Exchange rules. The Commission further notes that the Exchange proposes to adopt a requirement that an issuer must notify it in writing when it uses one of the exceptions from the shareholder approval requirements. The Commission believes that such a requirement, coupled with the additional disclosure requirements for inducement grants, should reduce the potential for abuse of any of the exceptions.¹⁹ In addition, the Exchange's proposed amendment to

¹⁶ See NASD Rule 2260; NYSE Rule 452; and Section 402.08 of the NYSE's Listed Company Manual.

¹⁷ See *supra* notes 3 and 16.

¹⁸ See *supra* note 3; see also *supra* note 10.

¹⁹ See also *supra* note 12 and accompanying text.

¹⁵ See *supra* note 3; see also *supra* note 10.