

market's rule, which period had not yet expired, the company would have the same transition period as would have been available to it on the other market. This transition period for companies transferring from another market would not apply to the audit committee requirements of Rule 10A-3 unless a transition period is available under Rule 10A-3.<sup>105</sup>

### C. Nasdaq Proposals

According to Nasdaq, the purpose of the Nasdaq Independent Director Proposal is to provide greater transparency regarding certain relationships that would preclude a board of directors from finding that an individual can serve as an independent director, and to increase the role of independent directors on board committees.<sup>106</sup> In Nasdaq's view, the proposal is intended to enhance investor confidence in the companies that list on Nasdaq.<sup>107</sup> According to Nasdaq, the purpose of the Nasdaq Going Concern Proposal is to bring notice of a going concern qualification to investors and potential investors;<sup>108</sup> the purpose of the Nasdaq Related Party Transactions Proposal is to improve investor protection;<sup>109</sup> the purpose of the Nasdaq Issuer Applicability Proposal is to alert investors to the exemptions that may be granted to foreign issuers;<sup>110</sup> and the purpose of the Nasdaq Code of Conduct Proposal is to provide further assurance to investors, regulators, and Nasdaq that each of Nasdaq's issuers has in place a system to focus attention throughout the company on the obligation of ethical conduct, encourage reporting of potential violations, and deal fairly and promptly with questionable behavior.<sup>111</sup>

#### 1. Independence of Majority of Board Members

Nasdaq proposes to amend Nasdaq Rule 4200, which sets forth definitions, and Nasdaq Rule 4350, which governs qualitative listing requirements for Nasdaq National Market and Nasdaq SmallCap Market issuers (other than limited partnerships). Under the amendment to NASD Rule 4350(c)(1), a majority of the directors on the board of a Nasdaq-listed company would be required to be independent directors, as defined in NASD Rule 4200. Nasdaq proposes to require each listed company

to disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board has determined to be independent under NASD Rule 4200.<sup>112</sup>

If an issuer fails to comply with this requirement due to one vacancy, or one director ceases to be independent due to circumstances beyond their reasonable control, Nasdaq proposes to require the issuer to regain compliance with the requirement by the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement.<sup>113</sup> Nasdaq proposes to require any issuer relying on this provision to provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.<sup>114</sup>

Pursuant to current NASD Rule 4200(a)(15), a director would not be independent if the director is an officer or employee of the company or its subsidiaries, or any other individual having a relationship which, in the opinion of the company's board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.<sup>115</sup>

The NASD proposes to revise NASD Rule 4200(a)(15)(A) through (E) and add subparagraphs (F) and (G). NASD Rule 4200(a)(15) provides a list of relationships that would preclude a board finding of independence. First, a director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company, would not be deemed independent ("Nasdaq Employee Provision").<sup>116</sup>

Second, a director who accepts or has a Family Member<sup>117</sup> who accepts any payments from the company, or any parent or subsidiary of the company, in excess of \$60,000 during the current fiscal year or any of the past three fiscal years, other than certain permitted payments,<sup>118</sup> would not be deemed

independent ("Nasdaq Payments Provision").<sup>119</sup>

Nasdaq proposes to state in the interpretive material to its rules ("Interpretive Material") that the Nasdaq Payments Provision is generally intended to capture situations where a payment is made directly to, or for the benefit of, the director or a family member of the director.<sup>120</sup> For example, consulting or personal service contracts with a director or family member of the director or political contributions to the campaign of a director or a family member of the director would be considered under the Nasdaq Payments Provision.<sup>121</sup>

Third, a director who is a Family Member of an individual who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company as an executive officer, would not be deemed independent ("Nasdaq Family of Executive Officer Provision").<sup>122</sup>

Fourth, a director who is, or has a Family Member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, other than certain permitted payments,<sup>123</sup> would not be deemed independent ("Nasdaq Business Relationship Provision").<sup>124</sup> In

plan, or non-discretionary compensation; and loans permitted under section 13(k) of the Exchange Act. 78 U.S.C. 78m(k). See NASD Rule 4200(a)(15)(B). In Amendment No. 3 to the Independent Director Proposal, *supra* note, Nasdaq proposes to add compensation for board committee service and loans permitted under section 13(k) of the Exchange Act to permitted payments. See *also infra* note 122.

<sup>119</sup> See NASD Rule 4200(a)(15)(B).

<sup>120</sup> See Amendment No. 3 to the Independent Director Proposal, *supra* note 12.

<sup>121</sup> See NASD IM-4200—Definition of Independence—Rule 4200(a)(15).

<sup>122</sup> See NASD Rule 4200(a)(15)(C). In Amendment No. 3 to the Independent Director Proposal, *supra* note, Nasdaq proposes a conforming change in subparagraph (B) of NASD Rule 4200 to indicate that employment compensation to a Family Member of an Independent Director as permitted in that subparagraph applies only when the Family Member is not an executive of the company.

<sup>123</sup> Permitted payments would include payments arising solely from investments in the company's securities, and payments under non-discretionary charitable contribution matching programs. See NASD Rule 4200(a)(15)(D). In Amendment No. 3 to the Independent Director Proposal, *supra* note, Nasdaq proposes to include payments under non-discretionary charitable contribution matching programs as permitted payments.

<sup>124</sup> See NASD Rule 4200(a)(15)(D). In Amendment No. 3 to the Independent Director Proposal, *supra* note, Nasdaq proposes to expand this proposal to

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<sup>105</sup> *Id.*

<sup>106</sup> See Nasdaq Independent Director Proposal.

<sup>107</sup> *Id.*

<sup>108</sup> See Nasdaq Going Concern Proposal.

<sup>109</sup> See Nasdaq Related Party Transactions Proposal.

<sup>110</sup> See Nasdaq Issuer Applicability Proposal.

<sup>111</sup> See Nasdaq Code of Conduct Proposal.

<sup>112</sup> See Amendment No. 3 to the Nasdaq Independent Director Proposal, *supra* note, and NASD Rule 4350(c)(1).

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> See NASD Rule 4200(a)(15).

<sup>116</sup> See NASD Rule 4200(a)(15)(A).

<sup>117</sup> In Amendment No. 3 to the Independent Director Proposal, *supra* note, Nasdaq proposes to define "Family Member" as "a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home." See NASD Rule 4200(a)(14).

<sup>118</sup> Permitted payments would include compensation for board or board committee service; payments arising solely from investments in the company's securities; compensation paid to a Family Member who is a non-executive employee of the company or a parent or subsidiary of the company; benefits under a tax-qualified retirement