

its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for that determination. A member appointed under this exception would not be permitted to serve longer than two years and would not be permitted to chair the audit committee.¹⁵⁴ Nasdaq proposes to add to Interpretive Material the recommendation that an issuer disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) if any director is deemed independent but falls outside the safe harbor provisions of Rule 10A-3(e)(1)(ii).¹⁵⁵

In addition, Nasdaq will retain the requirement that at least one member of the audit committee have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.¹⁵⁶

Nasdaq proposes to delete from the Interpretive Material the discussion relating to determining whether a

person is an affiliate solely by virtue of stock ownership.¹⁵⁷

8. Cure Periods

Nasdaq proposes to add a cure period provision, as follows: (1) If a listed issuer fails to comply with the audit committee composition requirements under Rule 10A-3 and NASD Rule 4350(d)(2), because an audit committee member ceases to be independent for reasons outside the member's reasonable control, the audit committee member could remain on the committee until the earlier of the issuer's next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with the requirements; and (2) if an issuer fails to comply with the audit committee composition requirements due to one vacancy on the audit committee, and the aforementioned cure period is not otherwise being relied upon for another audit committee member, the issuer would have until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement.¹⁵⁸ An issuer relying on either of these provisions would be required to provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

9. Notification of Noncompliance

Nasdaq proposes to require that an issuer provide Nasdaq with prompt notification after an executive officer of the issuer becomes aware of any material noncompliance by the issuer with the requirements of NASD Rule 4350.¹⁵⁹

10. Code of Business Conduct and Ethics

In the Nasdaq Code of Conduct Proposal, as amended,¹⁶⁰ Nasdaq proposes NASD Rule 4350(n) and related Interpretive Material, which would require each listed company to adopt a code of conduct applicable to all directors, officers and employees, and to make such code publicly available. The code of conduct would be required to comply with the definition of a "code of ethics" set forth in Section 406(c) of the Sarbanes-Oxley Act and any regulations thereunder. In addition, the code must provide for an enforcement mechanism

that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.

Moreover, any waivers of the code for directors or executive officers must be approved by the board and disclosed in a Form 8-K within five days.

In the Interpretive Material, Nasdaq proposes that the requirement of a publicly available code of conduct applicable to all directors, officer and employees of an issuer is intended to demonstrate to investors that the board and management of Nasdaq issuers have carefully considered the requirement of ethical dealing and have put in place a system to ensure that they become aware of and take prompt action against any questionable behavior. Nasdaq states that, for company personnel, a code of conduct with enforcement provisions provides assurance that reporting of questionable behavior is protected and encouraged, and fosters an atmosphere of self-awareness and prudent conduct.

11. Public Announcement of Audit Opinions With Going Concern Qualifications

In the Nasdaq Going Concern Proposal,¹⁶¹ Nasdaq proposes to amend NASD Rule 4350(b) to require each Nasdaq-listed company that receives an audit opinion that contains a going concern qualification to make a public announcement through the news media disclosing the receipt of such qualification. Under the proposal, the issuer, prior to the release of the public announcement, would be required to provide the text of the public announcement to the StockWatch section of Nasdaq's MarketWatch Department. The public announcement must be provided to Nasdaq StockWatch and released to the media not later than seven calendar days following the filing of the audit opinion in a public filing with the Commission.¹⁶²

12. Related Party Transactions

In the Nasdaq Related Party Transactions Proposal, as amended,¹⁶³ Nasdaq proposes to amend NASD Rule 4350(h) to specify that each issuer shall conduct an appropriate review of all related party transactions for potential conflict of interest situations on an ongoing basis and all such transactions would have to be approved by the listed

¹⁵⁴ See NASD Rule 4350(d)(2)(B). In Amendment No. 3 to the Independent Director Proposal, *supra* note 12, Nasdaq proposes to delete a previously proposed provision that would have permitted membership on the audit committee, under certain circumstances, of a director who owns or controls a specified percentage of the issuer's voting securities.

¹⁵⁵ See Amendment No. 3 to the Independent Director Proposal, *supra* note 12. Among other criteria, section 10A(m) of the Exchange Act and Rule 10A-3 thereunder provide that a member of an audit committee of an issuer is not considered "independent" if the member is an "affiliated person" of the issuer or a subsidiary. An "affiliated person" includes, among other things, a person who "controls" the issuer. The safe harbor of Rule 10A-3(e)(1)(ii) provides that a person who is not an executive officer of the issuer and is not the beneficial owner, directly or indirectly, of 10% or more of any class of voting equity securities of the issuer is deemed not to control the issuer for purposes of determining affiliation. However, a person who exceeds the 10% beneficial ownership is not presumptively deemed to control the issuer, and thus could still be deemed independent under the particular facts and circumstances. See Rule 10A-3(e)(1)(ii)(B).

¹⁵⁶ See NASD Rule 4350(d)(2)(A). In Amendment No. 3 to the Independent Director Proposal, *supra* note 12, Nasdaq proposes to clarify in Interpretive Material that a director who qualifies as an audit committee financial expert under Item 401(h) of Regulation S-K or Item 401(e) of Regulation S-B is presumed to qualify as a financially sophisticated audit committee member.

¹⁵⁷ See Amendment No. 3 to the Independent Director Proposal, *supra* note 12.

¹⁵⁸ See NASD Rule 4350(d)(4)(A) and (B).

¹⁵⁹ See NASD Rule 4350(m), which was added by Amendment No. 3 to the Independent Director Proposal, *supra* note 12.

¹⁶⁰ See the Nasdaq Code of Conduct Proposal, as amended, *supra* notes 25 and 28.

¹⁶¹ See the Nasdaq Going Concern Proposal.

¹⁶² See NASD Rule 4350(b)(1)(B).

¹⁶³ See the Nasdaq Related Party Transactions Proposal, as amended, *supra* notes 16, 18, and 19.