

**REPORT OF THE NEW YORK STOCK  
EXCHANGE CORPORATE ACCOUNTABILITY  
AND LISTINGS STANDARDS COMMITTEE**

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On June 6, 2002, the New York Stock Exchange (the "NYSE") released a report (the "Report") from its Corporate Accountability and Listing Standards Committee (the "Committee") proposing new standards intended to "enhanc[e] the accountability, integrity and transparency" of NYSE-listed companies by strengthening the corporate governance and disclosure practices of those companies. The Committee's recommendations include, among others:

- Increasing the role and authority of independent directors;
- Tightening the definition of "independent" director and adding new audit committee qualification requirements;
- Fostering a focus on good corporate governance;
- Giving shareholders more opportunity to monitor and participate in the governance of their companies; and
- Establishing new control and enforcement mechanisms.

The NYSE is now soliciting comments on the Report and intends to seek its approval at a meeting of the NYSE Board of Directors on August 1, 2002. Assuming approval of the Report by the NYSE Board of Directors, the NYSE would subsequently file proposed rules implementing the Report with the Securities and Exchange Commission (the "SEC") pursuant to the Securities and Exchange Act of 1934. The SEC may, after the applicable comment period, approve the proposed rules or approve modified rules or make additional proposals based on the comments received.

The primary differences between the measures contained in the Report and the NYSE's current rules include:

- Requiring independent directors to comprise a majority of the board of directors;<sup>1</sup>
- Listed companies must have an audit committee, a nominating/corporate governance committee and a compensation committee, each of which is comprised solely of independent directors;<sup>2</sup>
- The board of directors must affirmatively determine the director has no “material relationship” with the listed company in order for a director to be considered “independent”;<sup>3</sup> and
- Shareholders must be provided the opportunity to vote on all equity-based compensation plans and brokers may not vote customer shares unless they receive voting instructions.<sup>4</sup>

For a more complete summary of the differences between the Committee’s recommendations and the current NYSE listing standards, please see Appendix A prepared by the NYSE.

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**LISTED COMPANIES MUST HAVE  
A MAJORITY OF INDEPENDENT DIRECTORS**

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**GENERAL**

The Committee’s chief goal was to increase the integrity and transparency of listed companies by strengthening the internal checks and balances of the corporate governance system. The chief mechanism to achieve the Committee’s goal is the Committee’s recommendation that a majority of the board of directors of a listed company should be

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- <sup>1</sup> Under the current rule, the audit committee of a listed company must have at least three independent directors.
  - <sup>2</sup> Under the current rules, listed companies must have an audit committee consisting entirely of independent directors; however, listed companies are not required to have a nominating/corporate governance committee or compensation committee.
  - <sup>3</sup> Under the current rules, “independence” is defined solely for purposes of audit committee membership. A director is independent if he or she has no relationship to the company that may interfere with the exercise of the director’s independence from management and the company.
  - <sup>4</sup> Under the current rules, shareholder approval is required of equity-compensation plans in which officers or directors may participate, but broad based plans and one-time employment inducements are exempt.

comprised of “independent” directors. By mandating that a majority of the board of directors be independent, the Committee is attempting to alleviate conflicts of interest and improve corporate oversight. As currently proposed, the Committee plans to establish a 24-month period within which companies must achieve majority-independence. In addition, the Report would require a company to disclose publicly when it complies with this majority-independence requirement.

#### **TIGHTENING THE DEFINITION OF “INDEPENDENT DIRECTOR”**

The Committee has proposed altering the definition of “independent” so that a director cannot qualify as independent unless and until the board of directors affirmatively determines that the director “has no material relationship with the listed company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the company.” The Report does not explicitly state what constitutes a “material relationship,” but instead states that a board of directors makes that determination “broadly considering all relevant facts and circumstances.” The Report does state that in making determinations as to a director’s independence, the board of directors should make the determination considering the relationship from both the viewpoint of the director and also from the viewpoint of the persons or organizations with which the director is associated. Furthermore, the Report notes that material relationships can include, among others, commercial, banking, consulting and charitable relationships.

The Report considers certain relationships a *per se* bar on a director being considered independent until after the expiration of a five-year “cooling off” period. These relationships include present employees of the company, or of the company’s auditors, as well as a situation where an executive officer of the listed company serves on the compensation committee of another company that employs the director. In addition, directors with immediate family members in any of the above categories similarly would be precluded from being deemed “independent” until the expiration of the five-year period. The Committee suggests that ownership, or affiliation with the owner, of less than a controlling amount of stock, would not constitute a *per se* bar on being deemed independent.

In addition, under the Committee’s proposal, companies must disclose the basis of their determinations of director’s independence (that a relationship is not material) in the company’s proxy statement. Under the current definition, in order to be deemed “independent” a director is prohibited from having any relationship that may interfere with his or her exercise of independence from management and the company; however, the current definition does not generally require a formal decision by the board of directors. We believe that the requirement to disclose the basis for the determination of independence could cause companies to be more conservative in determining whether directors are, in fact, independent.

#### AUDIT COMMITTEE INDEPENDENCE

In addition to the above requirements for independence, membership on the company's audit committee would require a heightened degree of independence. For purposes of audit committee membership, the following additional requirements would need to be met:

- Director's fees are the only compensation members may receive;<sup>5</sup>
- Directors who satisfy all other facets of the definition of "independence" but also own 20% or more of the company's common stock (or are a general partner, controlling shareholder or officer of such a holder) cannot chair, or be a voting member of, the audit committee; and
- The audit committee chair must have accounting or related financial management expertise.

Currently, all audit committee members must be financially literate and one member must have accounting or related financial management expertise. The Report specifically requires that the chair of the audit committee have accounting or related financial management expertise. The Committee's suggestion that present or past service as a senior executive of a corporation is sufficient to fulfill the requisite accounting/financial expertise should make this requirement easily satisfied by most companies.

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#### NEW CORPORATE GOVERNANCE GUIDELINES

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The Report contains numerous recommendations that would empower the board of directors to provide a greater check against management power by creating greater independence and increasing specialization within the board itself. The following is a summary of the proposals:

- **Empowering non-management directors.** In order to provide greater and more frank review of management, the Committee proposes that non-management directors meet at regularly scheduled executive sessions attended by those directors; management would be excluded. The name of the director who will lead these meetings must be disclosed in the annual proxy statement. This proposal would formalize the

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<sup>5</sup> Directors' fees include normal compensation paid to directors as well as additional amounts paid to chairs of committees or as compensation for additional responsibility on the board of directors. In addition, a director may receive a pension or similar compensation for past performance, provided, that such compensation is not conditioned on continued or future service to the company.

practice of many companies that have already named “lead” outside directors.

- **Requiring listed companies to have a nominating/corporate governance committee composed exclusively of independent directors.** The nominating/corporate governance committee must have a written charter addressing the committee’s purpose and its goals and responsibilities. The nominating/corporate governance committee’s purpose is to, among other things, identify individuals to be elected to the board; to select, or recommend that the board select, the nominees for board membership at the next shareholder meeting; and to develop corporate governance guidelines. The nominating/corporate governance committee’s goals and responsibilities include, among other things, the criteria for selecting new board members (which may also include criteria for the removal of directors) and supervising the evaluation of the entire board and management. The nominating/corporate governance committee would have the authority to hire third-parties to aid in these tasks.
  
- **Requiring listed companies to have a compensation committee composed exclusively of independent directors.** The compensation committee must also have a written charter addressing the committee’s purpose, the committee’s duties and responsibilities, and an annual performance evaluation of the committee. The compensation committee’s purpose is to, among other things, set the compensation of senior executives and management, and produce the required materials for inclusion in the company’s proxy statement. The compensation committee’s responsibilities include, among other things, creation of the compensation criteria for the CEO, annual evaluation of the CEO’s performance and setting the CEO’s compensation based on this evaluation. In addition, the compensation committee must make recommendations to the board of directors with respect to equity- and incentive-based plans.
  
- **Increasing the authority and responsibilities of the audit committee, including granting the committee the exclusive authority to hire and remove independent auditors and to approve any “significant” non-audit relationship with the independent auditors.** The audit committee’s purpose must be expanded, at a minimum, to assist board oversight of: the integrity of the company’s financial statements; compliance with legal and regulatory requirements; the independent auditor’s qualifications and independence; performance of the internal audit function and the independent auditors. In addition the charter should contain the duties of the audit committee which, at a minimum,

must be to prepare the report to be included in the company's proxy statement; retain and terminate the company's independent auditor (including exclusive authority to establish all fees for audit engagements and significant non-audit engagements); annually review a report from the independent auditor describing the auditing firm's internal quality-control procedures, any material issues raised by the most recent internal quality-control review, or peer review, of the auditing firm; discuss the annual audited financial and quarterly statements with management and the independent auditor; discuss earnings press releases and guidance; as appropriate, obtain advice and assistance from outside legal, accounting or other advisors; discuss policies with respect to risk assessment and risk management; meet separately, at least quarterly, with management, internal auditors and the independent auditor; review with the independent auditor any audit problems or difficulties and management's response; set clear hiring policies for employees or former employees of the independent auditors; and report regularly to the full board with respect to any issues raised by the foregoing.

- **Increase shareholder control over equity-compensation plans.** Shareholders must be given the opportunity to vote on all equity compensation plans. Under the current rules, shareholder approval is required of equity-compensation plans in which officers or directors may participate, but broad based plans and one-time employment inducements are exempt. In addition, a broker may not vote a customer's shares on any equity compensation plan unless the broker has received that customer's instructions to do so. Under the current NYSE rules, brokers may vote by proxy stock held by the broker if the broker has not received voting instructions from the beneficial owner of the shares and the broker is not aware of any matter to be contested at such meeting.
- **Adopt and disclose corporate governance guidelines and a code of business conduct and ethics.** Every company must adopt guidelines pertaining to the responsibilities of board members, the qualifications for board membership, the responsibilities of board committees, compensation of board members and a code of business conduct and ethics. These guidelines and code, along with the charters of at least the audit, nominating and compensation committees and the corporate governance guidelines, must be posted on the company's website. In addition, any waiver of the code of ethics may only be made by the board or a committee of the board, and in the case of any waiver, be immediately disclosed to shareholders. Under current NYSE rules, there is no similar requirement.

- **Require the CEO to certify annually to the NYSE: that the company has established procedures for verifying the accuracy and completeness of the information provided to investors; that those procedures have been carried out; and that, based upon the CEO's assessment of the adequacy of those procedures and of the diligence of those carrying them out, the CEO has no reasonable cause to believe that the information provided to investors is not accurate and complete in all material respects. In addition, the CEO must certify that he or she has reviewed these procedures and the company's compliance with them with the board and that he or she is not aware of any violation by the company of the NYSE listing standards.** By requiring the CEO to certify that all of these procedures have been followed and that all the NYSE listing standards are met the Committee is attempting to ensure compliance by making the CEO accountable. The Committee is also seeking the ability to issue a public reprimand letter to any company violating the new listing standards as a lesser sanction for violations and only to suspend trading in or to delist a company for repeated or flagrant violations of the standards.
  
- **Require listed foreign private issuers to disclose any significant ways in which their corporate governance practices differ from those followed by domestic corporations under NYSE listing standards.** Foreign companies are permitted to adhere to the corporate governance requirements of their home country. The Committee, however, proposes that they must provide disclosure to U.S. shareholders highlighting the manner in which their country's practices differ from those under the NYSE listing standards.

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**OTHER RECOMMENDATIONS**

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In addition to the proposals highlighted above, the Committee proposed that the NYSE make recommendations to other institutions, such as the U.S. Congress and the SEC, for reforms those institutions are better suited to implement. These recommendations include, among other things, requiring public accountants to be regulated by an independent private-sector organization, requiring companies to report complete GAAP-based information in all public or shareholder communications before any reference to "pro forma" or "adjusted" information, and requiring CEOs to certify to shareholders that, to their best knowledge and belief, their companies' financial statements and disclosures fairly present the information that reasonable investors should have to make informed investment decisions.

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If you have any questions concerning the Report, please contact Vincent Pagano ([vpagano@stblaw.com](mailto:vpagano@stblaw.com)), Alan Schwartz ([aschwartz@stblaw.com](mailto:aschwartz@stblaw.com)), Ray Wagner ([rwagner@stblaw.com](mailto:rwagner@stblaw.com)) or Frank Marinelli ([fmarinelli@stblaw.com](mailto:fmarinelli@stblaw.com)) of our firm at (212) 455-2000.

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APPENDIX A



NYSE Committee Recommendation

Current Rule(s)

Independent directors must comprise a majority of a board.	Listed company must have an audit committee composed of at least three independent directors.
Non-management directors must meet without management in regular executive sessions.	No such requirement.
Listed companies must have an audit committee, a nominating committee and a compensation committee, each comprised solely of independent directors.	Listed companies must have an audit committee comprised solely of independent directors. No requirement for establishment or composition of nominating or compensation committees.
The chair of the audit committee must have accounting or financial management experience.	All committee members must be financially literate and at least one must have accounting or financial management expertise.
Audit committee must have sole responsibility for hiring and firing the company's auditors, and for filing any significant non-audit work by the auditors.	Audit committee charter must provide that selection and firing of the independent auditor is subject to the "ultimate" authority of the audit committee and the board of directors.

For a director to be deemed “independent,” the board must affirmatively determine the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company).	Existing definition precludes any relationship with the company that may interfere with the exercise of director’s independence from management and the company.
Independence also requires a five-year “cooling-off” period for former employees of the listed company, or of its independent auditor; for former employees of any company whose compensation committee includes an officer of the listed company; and for immediate family members of the above.	Cooling-off period is three years; does not specifically apply to former employees of the auditor or any company whose compensation committee includes an officer of the listed company. Board of directors can make an exception for one former officer, provided the reason is explained in the next proxy statement.
Director’s fees must be the sole compensation an audit committee member receives from the listed company; further, an audit committee member associated with a major shareholder (one owning 20% or more of the listed company’s equity) may not vote in audit committee proceedings.	No current requirement.
Listed companies must adopt a code of business conduct and ethics, and must promptly disclose any waivers of the code for directors or executive officers.	No current requirements.
Shareholders must be given the opportunity to vote on all equity-based compensation plans. Brokers may only vote customer shares on proposals for such plans pursuant to customer instructions.	Shareholder approval required of equity-compensation plans in which officers or directors may participate, but broad-based plans and one-time employment inducements are exempt. Broker can vote customer shares except when given instructions from the customer, or when the action is contested.
Listed companies must publish codes of business conduct and ethics, and key committee charters. Waivers of such codes for directors or executive officers must be promptly disclosed.	No current requirements.

Listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from NYSE rules.	No current requirements.
Each listed-company's CEO must certify annually that the company has established and complied with procedures for verifying the accuracy and completeness of information provided to investors and that he or she has no reasonable cause to believe that the information is not accurate and complete. The CEO must further certify that he or she has reviewed with the board those procedures and the company's compliance with them.	No current requirements.
CEOs must also certify annually that they are not aware of any company violations of NYSE rules.	No current requirements.
Upon finding a violation of an Exchange rule, the NYSE may issue a public reprimand letter to any listed company and ultimately suspend or de-list an offending company.	No current provision for public reprimand.
The NYSE urges every listed company to establish an orientation program for new board members.	No such recommendation has been made previously.
In conjunction with leading authorities in corporate governance, the NYSE will develop a Directors Institute.	NYSE has generally supported education initiatives, but this will be the first formalized program designed for directors.