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NYSE Addresses Impact of Shareholder Approval Rules

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The New York Stock Exchange (NYSE) and NASDAQ revised their rules on shareholder approval of equity compensation plans, effective June 30, 2003. Last week, the NYSE issued responses to some frequently asked questions on the new rules. The responses address, among other things, the application of the rules to 401(k) and other plans that provide for distributions to participants in the form of company stock.

Plans that were in place before June 30, 2003 are generally exempt from the rules until they are materially amended. The new guidance makes clear that an amendment to a 401(k) plan will only be considered material "if it affects the company stock aspects of the plan in a way that is otherwise a material revision under the rules. For example, adding to or changing investment fundsÑother than a company stock fundÑto such a plan would not be considered a material revision." Unfortunately, the NYSE did not address whether adding an ESOP dividend payout feature (Code sec. 404(k)) would be material.

The NYSE responses also provide new guidance on the types of amendments to equity compensation plans that will be considered material under the rules. If an amendment does not fit into one of the examples of material revisions in the rules, the NYSE states that it will be considered material if it "would have the effect of materially increasing the potential dilution of shareholders over the lifetime of the plan" or if it has an effect similar to one of the listed examples. The NYSE then reaches the following conclusions on some common amendments:

- Adding awards of restricted stock units to a plan that permits awards of restricted stockÑNOT MATERIAL,
- Increasing a limit on the number of shares of restricted stock that may be awarded under a planÑMATERIAL,
- Adding awards of options to directors to a plan that permits option awards to employees and awards of restricted stock to directorsÑMATERIAL,
- Changing the vesting schedule for options issued under a plan (including for a change in control)ÑNOT MATERIAL.

The adoption of, or material amendment of, a qualified plan or employee stock purchase plan covered by the rules must be approved by the company's independent compensation committee or a majority of the companys independent directors, rather than by shareholders. The NYSE must also be notified of such approval; the new guidance provides information on how this notice is provided.

While it has not yet done so, the NASDAQ has indicated that it will also issue guidance on its new shareholder approval rules.