

NYSE Revises Independent Director Definition

On March 12, 2003, the New York Stock Exchange filed with the SEC proposed revisions to the director independence provisions that were originally included in the NYSE Corporate Governance Proposals filed last year. The SEC staff had requested that the NYSE separately file the provisions relating to director independence to enable the SEC to address the issue separately from the remainder of the original proposal. The NYSE expects the SEC to publish the director independence provisions for public comment before the remainder of the original proposal, but to make the entire proposal effective at one time.

A summary of the amended director independence provisions follows:

Basic Director Independence Requirements

The amendment did not change the basic director independence requirements in the original proposal which provided that:

- A majority of the directors of listed companies must be independent. An exemption is available for controlled companies.
- The board must affirmatively determine that an independent director has no material relationship with the listed company.

Amendments to Director Independence Definition

In addition to the requirement that the board affirmatively determine that an independent director has no material relationship with the listed company, the original proposal had additional specific independence criteria. One of these was that “no director who is a former employee of the listed company can be ‘independent’ until five years after the employment has ended.” The amended proposal replaces this requirement with the following specific financial criteria:

- A director who receives, or whose immediate family member receives, more than \$100,000 per year in direct compensation from the listed company is presumed not to be independent until five years after he or she ceases to receive more than \$100,000 in such compensation.
 - A board could override this presumption if it determines (and no independent director disagrees) that the compensatory relationship is not material. Any such determination must be explained in the listed company’s proxy statement.
- A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of another entity (A) that accounts for at least 2% or \$1 million, whichever is greater, of the listed company’s consolidated gross revenues, or (B) for which the listed company accounts for at least 2% or \$1 million, whichever is greater, of the other entity’s consolidated gross revenues, in each case is not independent until five years after falling below such threshold.

- This is not a presumption and, presumably, cannot be overridden by the board.

The amended proposal also retained, and in some cases modified slightly, the other specific independence criteria in the original proposal. Under the amended proposal these additional criteria are:

- A director who is employed, or whose immediate family member is employed, as an executive officer of another company where any of the listed company's present executives serves on that company's compensation committee is not independent until five years after the end of such service or the employment relationship.
 - This item is essentially the same as contained in the original proposal.
- A director who is affiliated with or employed by, or whose immediate family member is affiliated with or employed in a professional capacity by, a present or former auditor of the company is not independent until five years after the end of either the affiliation or the auditing relationship.
 - This item is essentially the same as contained in the original proposal, although under the amended rule, a family member must serve in a professional capacity for the auditor rather than in any employment capacity as provided in the original rule.
- For purposes of this rule, an "immediate family member" includes a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than employees) who shares such person's home.
- The amendment also phases in the five-year look-back or cooling-off provisions, rather than applying them immediately as provided in the original proposal. In effect, the look-back period would be the shorter of the period from the effective date of the rules or the previous five years. Thus, if a director received in excess of \$100,000 per year in direct compensation from a listed company during the year prior to the effective date of the rules, there will be no required presumption that the director is not independent unless such compensatory relationship extended past the effective date.

Effective Date of Independence Standards

All listed companies will be required to comply with the director independence standards no later than eighteen months following the SEC approval of the proposed rules. Companies listing in conjunction with their initial public offering will be required to comply within 24 months of listing. Companies listing upon transfer from another market will have 24 months from the date of transfer in which to comply with this standard if the market on which they were listed did not have the same requirement. If the other market had a substantially similar requirement, but also had a transition period from the effective date of the rule which has not yet expired, the company will have at least as long a transition period as would have been available to it on the other market.

Contact Information

If you have any questions or would like to learn more about the proposed rules, please contact the lawyer who normally represents you.