

# GUIDE FOR INDEPENDENT DIRECTORS



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## Defining 'Independent' Director

State corporation law, the predominant source of corporate governance law, generally does not distinguish between management and nonmanagement members of the board of directors, per se, although there is extensive state law concerning the interests board members might have in particular transactions. The particular roles expressly required to be filled by nonmanagement directors arise mainly under stock market rules and federal law, which use various criteria to define and terminology to refer to "independence" and similar concepts. Some of these definitions are set forth in Annex A. In this guide, the term "independent" will be avoided, except when used by the relevant authority.

## September 2008

### Pocket Guide for Independent Directors

Early in the decade, in response to well-publicized business failures and accounting improprieties, many new laws were enacted and rules adopted that put nonmanagement directors to the forefront of protecting investors' interests.

Corporate directors, and nonmanagement directors in particular, must maintain a degree of unaccustomed vigilance regarding corporate affairs and governance. The new laws have not changed the board's standard of diligence, but they certainly have attracted attention to it. This guide is intended to assist nonmanagement directors in fulfilling their fiduciary duties, addressing:

- board organization, authority, and responsibilities and functions of committees;
- fiduciary obligations and related liability; and
- indemnification and insurance.

This guide also contains answers to frequently asked questions.

Although intended to provide accurate information about the role of the nonmanagement director, this guide cannot address every law and rule related to corporate governance or anticipate every question a director might have. Nor do we discuss laws governing a director's conduct of his or her personal affairs that arise from his or her status as a director, such as insider trading rules. Please contact any of Loeb & Loeb LLP's corporate governance attorneys listed on the inside back cover for more information.

## Part I

### Board Organization, Authority and Responsibilities

In general, management of a corporation is divided between the board of directors and officers. Officers are directly responsible for a corporation's day-to-day operations, while the board usually plays a supervisory role. Therefore, the board must expressly authorize only those matters that are material or otherwise outside a company's ordinary course of business. Examples include appointing officers and setting their compensation, as well as authorizing significant contracts, such as major leases; officer employment contracts and employee benefit plans; bank borrowings; business acquisitions and mergers; declarations of dividends; and securities issuances.

#### Board Composition

Generally, the number of directors may be fixed by the board, often within a range stated in the certificate of incorporation or bylaws. Although directors are elected (or reelected) at annual stockholder meetings, boards are authorized to fill vacancies that occur between meetings. This authority includes appointing directors to fill vacancies created by the board's increasing the number of board seats.

Rules of the stock markets (i.e., New York Stock Exchange, Nasdaq and American Stock Exchange) require a majority of the directors to be "independent" (as defined in Annex A), unless the company is controlled by a person or group with more than 50 percent ownership of the outstanding stock. The rules require independent directors to meet regularly in executive session, without management board members.

#### Board and Executive Compensation

Boards are authorized to fix the compensation of directors for their services as such, including committee memberships, or any other capacity. Compensation, in any case, must be reasonable.

*(Note: Services provided by a director to a corporation in any capacity other than board or committee membership may affect the director's independent status.)*

Stock market rules set out procedures for approving compensation for the CEO and other executive officers, requiring decisions to be made by either a majority of the independent directors or a compensation committee comprised of independent directors, or, in the case of the NYSE, by the compensation committee alone.

#### Miscellaneous

Federal law (including the Sarbanes-Oxley Act) and stock exchange rules require the board to: (1) adopt and post on the company's Web site a code of ethics applicable to the CEO and CFO (which may be part of a broader code, e.g., applicable to the entire company); (2) in general, require stockholders to approve stock-based employee benefit plans and stock issuances to directors and company personnel; and (3) prohibit company loans to directors and executive officers.

## Procedural Authority

### Calling Meetings

Generally, a corporation's bylaws determine how board meetings can be called. Often meetings can be called at the direction of a specified number of directors. Bylaws that do not authorize board members to call a meeting can be amended to do so.

### Agenda and Appointment of Chairperson

Boards are authorized to set meeting agendas and to require management to address particular matters. A board can elect a chairperson from among its members to administer board functions and operations. The chairperson need not be the CEO or other member of management. A majority view among corporate governance commentators appears to be developing that the CEO and chairperson roles should be separated and the latter filled by an outside director.

### Access to Information

A director is entitled to examine any of the corporation's books and records and should be permitted to communicate or meet with any employee for a proper corporate purpose. Some jurisdictions consider the director's right of inspection to be "absolute."

### Access to Independent Counsel and Other Advisers

Generally, directors should not seek advice directly from independent counsel or other advisers except in special circumstances, such as takeovers or investigations into wrongdoing. Compensation committees, however, commonly engage compensation consultants. Under federal law and stock market rules, independent directors may choose to employ independent counsel, accountants or other advisers at company expense. For example, audit committees have been given exclusive authority to engage independent counsel and other advisers in carrying out their duties.

### Removal of Directors

In general, stockholders may remove a director for cause; their right to remove a director without cause may be more restricted. In some states, directors may be authorized to remove another director for cause.

### Removal of Officers

Corporate officers serve at the pleasure of the board. Even if the board's removing an officer would breach an employment contract, the officer cannot prevent his or her removal on this basis.

## Functions of Board Committees

In most cases, boards are empowered to establish committees with almost any authority that the board itself possesses. Such broad powers are sometimes vested in an “executive” committee. Committees formed for narrower purposes may be authorized to exercise the full power of the board with respect to specified matters or simply to investigate or make recommendations for board action.

Boards may establish standing or special committees in particular circumstances.

## Standing Committees

The functions of the most common standing committees are described below.

### **Audit Committee**

The audit committee oversees the corporation’s accounting functions, including financial reporting processes, internal controls and the independence of its external auditors.

Each listed public company is required by stock market rules to adopt a charter for its audit committee, setting forth: (1) the outside auditor’s ultimate accountability to the committee and the board of directors; (2) the committee’s specific duties, including particular subject matter it is required to review with the auditors and management; and (3) qualifications for committee membership, including independence and financial sophistication.

Federal law requires that, with limited exceptions, the audit committee be made up of independent directors only and defines “independence” for purposes of membership (see Annex A). Federal law also imposes the following requirements:

- The audit committee is directly responsible for appointing, setting the compensation for and overseeing the work of the company’s auditors, who must report directly to the audit committee.
- The audit committee is responsible for resolving disagreements between management and the auditors over financial reporting.
- The audit committee must establish procedures to receive and handle complaints regarding accounting, internal accounting controls or auditing matters and for anonymous, confidential submissions by employees regarding such matters.
- The audit committee must have authority and funding to hire independent counsel and other advisers in carrying out its duties.

Stock market rules require the audit committee or another independent committee to monitor transactions between the company and its directors or executive officers.

The proxy statement each year must include an audit committee report regarding the prior year's audit and, among other things, discuss the independence of its members and whether the committee has an "audit committee financial expert."

### **Compensation Committee**

The compensation committee recommends or approves compensation for officers and senior management as well as executive compensation programs. Securities and Exchange Commission (SEC) rules and the Internal Revenue Code dictate creation of a compensation or equivalent committee comprised of nonmanagement directors. Stock market rules require that executive compensation be determined by a majority of independent directors or a compensation committee made up of independent directors.

Each company's proxy statement must contain a compensation discussion and analysis discussing the company's executive compensation policies in detail.

### **Nominating and Corporate Governance Committees**

Traditionally, the chief responsibility of the nominating committee is to identify, vet and recommend candidates for board membership. It may frequently be assigned corporate governance supervision as well. The committee may recommend board committee assignments or board compensation; assess board, board member or executive officer performance; evaluate management organizational structure; or oversee executive officer succession matters, among other functions. The committee should maintain a record of considering the performance of incumbent directors in determining whether to recommend them for reelection.

Stock market rules encourage, or in the case of the NYSE, require boards to establish nominating committees. Detailed disclosure of a company's director nominating process is required in the proxy statement.

### **Special Committees**

Boards may form special committees from time to time to deal with nonrecurring matters, such as a special litigation committee comprised of disinterested directors to handle derivative actions or investigations of insider misconduct. Boards may also form special committees of nonmanagement directors to consider going-private transactions or mergers involving interested directors and officers. Ordinarily, in such cases, the special committee will have authority to engage independent counsel and other professional advisers of its own choosing.

## Part II

### Fiduciary Obligations and Related Liability

The fundamental responsibility of a board of directors is to oversee and supervise the management of the company's business.

All directors of a corporation, whether "independent" or not, owe fiduciary obligations to the company and its stockholders. These include the duty of care and the duty of loyalty and, within these duties, the duty of disclosure. The extent of these fiduciary obligations varies from state to state.

The following discussion focuses in several instances on directors' fiduciary obligations as they exist under Delaware law, since a large proportion of public companies are incorporated in that state.

#### Fiduciary Obligations

##### Duty of Care

In general, the duty of care requires that a director:

- act on an informed basis;
- exercise the care that a person in a like position would exercise under similar circumstances; and
- act in a manner reasonably believed to be in the best interests of the corporation.

A director must comply with the duty of care when making a business decision at a particular time for a specific purpose (e.g., in connection with a transaction) or when overseeing the corporation's business and affairs generally.

##### Making Informed Business Decisions

The duty of care requires directors to make reasonable efforts to reach informed business decisions. This is determined based on whether:

- Prior to making a decision, the directors have all pertinent material information and an adequate amount of time to evaluate the information.
- The directors have reasonably informed themselves regarding alternatives before reaching a decision.

##### Oversight

In overseeing a corporation's business and affairs, the board must exercise reasonable care to ensure that the company's officers are meeting their managerial responsibilities. To carry out their oversight function, directors must receive timely, adequate information from management about the corporation's business. The

duty of care requires the director to review such information and make further inquiries when necessary. If a director does not receive information about the corporation's business operations from management in a timely manner, or the information provided is inadequate for the director to properly provide oversight, the director is responsible for pursuing these matters with management.

### **Duty of Loyalty**

The duty of loyalty is the director's affirmative obligation to refrain from putting the director's personal interests ahead of the interests of the corporation or its stockholders. Cases involving breach of the duty of loyalty inherently involve conflicts of interest, such as may be involved in a transaction between a director and the company or usurpation of a corporate opportunity.

Although state corporation laws generally do not prohibit transactions between a corporation and its directors, in such transactions directors must avoid breaching their duty of loyalty. Accordingly, a director who intends to enter a transaction with a corporation should disclose all pertinent material information and obtain the approval of a majority of disinterested directors (and stockholders, if necessary).

As noted above, federal law prohibits loans by a company to directors or executive officers, and stock market rules require the audit or another independent committee to monitor insider transactions.

### **Duty of Disclosure**

The duty of disclosure requires directors to fully and fairly disclose all material information within the board's control when seeking stockholder action. It also requires them to know that information disclosed to stockholders is true.

### **Special Fiduciary Obligations of Directors of Insolvent Company or Company "in Play"**

Although perhaps not clearly defined in all situations, as a general matter, when a company becomes insolvent or its sale or breakup appears inevitable, directors have a duty to maintain the corporation's value for the benefit of its stakeholders.

## **Liability in Relation to Fiduciary Obligations**

### **The Business Judgment Rule**

The business judgment rule is a presumption by the courts that a business decision has been made by disinterested directors on an informed basis and with a good faith belief that it will serve the best interests of the corporation. The practical effect of applying this rule in a breach of duty case is that the court, without inquiry, will assume that directors have complied with their fiduciary duties and are not liable. The rule presumes that directors, in making a business decision, have met the

following five elements of the rule:

- The subject of the decision was a corporate business matter.
- The director was disinterested, that is, did not have a personal stake in the outcome of the decision and was not subject to influences other than the corporate merit of its subject matter.
- The director exercised due care by making the decision on an informed basis.
- The director acted in good faith, that is, did not make the decision for any purpose other than a genuine attempt to advance corporate welfare.
- The director did not abuse discretion by making a decision not attributable to any rational business purpose.

Unless it is shown that one (or more) of these elements was not met in the decision making, the court will not substitute its judgment for that of the board of directors. Accordingly, directors who have satisfied these fiduciary obligations generally will not face liability for their business decisions, even if they result in harm to the corporation or its stockholders.

### **Independent Review of Directors' Decisions**

If the directors do not satisfy the criteria of the business judgment rule in making a business decision, the court will independently review their decision and determine the extent of their liability for any harm resulting from the decision.

Personal liability for breach of duty of care requires gross negligence by directors, not merely negligent conduct. In this context, gross negligence means that the directors acted with reckless indifference to – or in deliberate disregard of – the interests of the corporation or its stockholders, or took actions outside the bounds of reason.

A director determined by the court to have breached the duty of loyalty by entering a transaction with the corporation will be liable to the extent the transaction was not fair to the corporation. Fairness in this context means that there was fair dealing in effecting the transaction, including appropriate disclosure, and the price of the transaction was fair.

### **Charter Exculpation**

Delaware law authorizes a certificate of incorporation to contain a provision “eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages” for breach of the fiduciary duty of care. In some states, broader exculpation, including for breach of the duty of loyalty, is permitted. The Delaware courts have made clear, in any case, that the charter provisions do not protect directors who simply do nothing when board action of some sort is required.

## Liability in Connection with Federal Securities Laws

### Applicable Provisions

Section 11 of the Securities Act of 1933 imposes liability on any director of a corporation filing a registration statement under that Act that contains an untrue statement of a material fact or omits to state a material fact required to be included or necessary to make the statements in the registration statement not misleading, unless the director establishes that, after reasonable investigation, the director believed, and had reasonable grounds to believe, the statement to be true.

Section 21D(f) of the Securities Exchange Act of 1934 sets forth, with respect to plaintiff class actions, the criteria for determining the proportionate liability of so-called “covered persons,” including an outside director; the level of responsibility of a covered person; and the right of contribution, if any, of that person. Section 21D(f) provides that a covered person will be liable jointly and severally only if a trier of fact specifically determines that the person knowingly violated securities laws.

In determining the amount of liability of a covered person, the Exchange Act sets forth the following three factors to consider:

- whether the person violated securities laws;
- the person's degree of responsibility, measured as a percentage of the total fault of all persons who caused or contributed to the loss incurred by the plaintiff; or
- whether such person knowingly violated securities laws (i.e., whether there will be liability jointly and severally).

When determining the percentage of responsibility, facts to consider include the nature of the conduct of each covered person found to have caused or contributed to the loss incurred by the plaintiffs, and the nature and extent of the causal relationship between the conduct of each person and the damages incurred by the plaintiffs.

### Corporate Governance Climate

The vast majority of recent cases of breach of fiduciary duty by directors were sins of omission or neglect. Corporate governance practitioners have been surprised that many of the scandals that initiated the new governance regime arose from inattention to basic principles. By the same token, laws and rules adopted in the last few years, in general, attempt to ensure that directors satisfy their existing responsibilities, rather than create new ones. Directors can avoid exposure to liability by applying to company affairs the same degree of attention and intellectual vigor as they apply to their own.

## Part III

### Indemnification and Insurance

#### Indemnification Afforded by State Law, Charter and Contract

##### State Statutes

Corporations are authorized by statute to use corporate funds to indemnify directors and officers for certain personal losses incurred by them in their official capacities.

##### SEC Position on Indemnification

In the opinion of the SEC, indemnification of officers and directors from Securities Act liability is against public policy and may not be permitted.

##### Charter and Bylaw Provisions

Specific charter and bylaw provisions may provide additional protection against personal loss for directors and officers. For example, corporate laws in New York and Delaware authorize indemnification of directors generally in permissive terms; that is, the laws permit a corporation to indemnify or advance expenses under specified circumstances, but require indemnification only when a director prevails in court (or the court otherwise decides). Certificate of incorporation or bylaw provisions allow corporations to obligate themselves to indemnify their directors and officers more broadly than required by statute. Two examples are provisions (1) making permissive indemnification mandatory, and (2) requiring reimbursement of the director's expenses (including attorneys' fees) in advance of the final disposition of an action with respect to which a claim for indemnity may be made. Although such provisions generally are considered a contract between the corporation and the persons they cover, they are subject to amendment in the same manner as other charter or bylaw provisions.

##### Indemnification Contracts

A director may be able to enforce an indemnification contract more readily than charter or bylaw provisions because the corporation could not unilaterally amend or revoke the contract, in case of a dispute with the director or after a change in control, for example. Accordingly, an indemnity agreement may best assure that the corporation will be required to honor its indemnification and expense advancement obligations.

Outside directors are urged to review the corporation's charter documents and indemnification contracts, if any, to determine whether they contain sufficiently broad indemnification and limitation of liability provisions. To ascertain the true

adequacy of protection in the event of a claim, the outside director should also carefully review the corporation's directors' and officers' liability insurance policy.

## Directors' and Officers' Insurance

### General

"D&O insurance," as directors' and officers' liability insurance is generally known, is a type of property and casualty coverage similar to professional liability (malpractice) insurance. Generally, a D&O policy is a claims-made policy, that is, it will provide coverage only if it is in effect at the time a claim is made (as opposed to the time when the action upon which the claim is based occurred). The D&O policy serves two purposes:

- It protects the corporation from some sizable losses it could incur because of indemnification of officers and directors.
- It protects the insured directors and officers directly for certain losses against which the corporation does not or cannot indemnify them.

In addition, most policies will protect the corporation from particular types of claims, such as securities claims brought against the corporation itself that arise from director or officer conduct.

### Exclusions

D&O insurance policies are not written on a standardized form and contain materially different terms, but most contain parallel provisions that typically exclude:

- fines and penalties;
- claims attributable to dishonest, fraudulent, criminal or malicious acts;
- claims for misconduct personally benefiting the insured officer or director.

### D&O Policies Are Contracts

D&O insurance is an independent, contractual source of indemnity. Payment under a valid policy is conditioned on neither the economic soundness of the corporation nor the willingness of management to pay the losses of the indemnitee. If a company is in financial trouble, money for indemnification may not be available, regardless of what the bylaws say or the board resolves. When a corporation is insolvent, mandatory indemnification bylaws or agreements, unless independently funded, may entitle the indemnitee merely to take a place in line with other unsecured creditors.

## **Policy Provisions**

Careful attention should be paid to retentions and exclusions, particularly those that seek to limit coverage based on a lack of adequate insurance for other business matters or assertions that a corporation's financial statements were inaccurate when the policy was issued. It is essential that a D&O policy contain broad severability (or nonimputation) provisions so that actions, statements or knowledge of one director or officer cannot be imputed to other directors or officers covered by the policy, protecting the "innocent" from loss of coverage. To avoid ambiguity that might exist as to directors' rights to coverage and reimbursement of expenses in the case of bankruptcy, many corporations purchase supplemental insurance policies covering directors and officers only, in addition to the usual policies that cover both the company and its directors and officers.

## FAQs for Independent Directors

**Q:** Can the board of directors fix agendas for board meetings or instruct management regarding what information should be prepared for the board?

**A:** Yes.

**Q:** Can management members of the board be excluded from board meetings from time to time to allow independent members to meet alone?

**A:** In general, a board action requires a duly convened meeting. In some circumstances, a meeting excluding certain board members might not constitute a duly convened meeting. Independent board members should be free to meet informally, even if they will not be able to take binding action. For example, the major stock markets have rules requiring independent board members to meet regularly without management or management directors present.

**Q:** Which corporate books and records can a director review, and which employees can a director meet with or interview?

**A:** A director is entitled to examine any of the corporation's books and records and should be permitted to communicate or meet with any employee for a proper corporate purpose. Some jurisdictions consider the director's right of inspection to be "absolute."

**Q:** What board committees can be established?

**A:** Generally, the board of directors may establish committees to exercise all but certain enumerated powers of the board, but such wholesale delegation of authority is rare. The most common are the audit committee, the compensation committee, and the nominating and corporate governance committee. Frequently, board committees are assigned investigative or recommendatory authority only, or their binding authority is limited to specific items.

**Q:** What are the duties of an audit committee?

**A:** The audit committee oversees all the corporation's accounting functions, including financial reporting processes, internal controls and independent external auditors. Federal law requires the audit committee to select, engage and have direct supervisory authority over a public corporation's external auditors. A more detailed discussion can be found on page 7.

**Q:** What are the duties of a compensation committee?

**A:** The compensation committee recommends or approves compensation for officers and senior management as well as executive compensation programs. Further discussion appears on page 8.

**Q:** Can a nominating committee nominate board candidates whom management has not approved?

**A:** Yes, but ordinarily senior management should have a role in selecting director candidates.

**Q:** What indemnification rights should I ask the company to provide for me?

**A:** You should inquire whether its certificate of incorporation or bylaws contain indemnification provisions. State corporate laws generally require corporations to indemnify against expenses incurred by a director in a successful defense of claims against the director incurred in such capacity. Many states authorize corporations to provide indemnification beyond the minimum required by statute. When this is so, a director should confirm that the certificate of incorporation or bylaws obligate the corporation to indemnify directors as broadly as possible. You may want to ask whether the corporation will provide a separate indemnification contract in addition to charter documents.

**Q:** Should the company provide me with insurance against director liability?

**A:** You should be satisfied that the corporation has adequate resources, whether through insurance or available funds, to provide adequate protection in the event of a liability claim.

**Q:** If I am sued, how will my legal fees be paid?

**A:** Make sure the indemnification provisions of the corporation's charter documents or a separate indemnification agreement require reimbursement of legal costs you incur in pursuing a successful indemnity claim, if the company refuses to indemnify voluntarily. Also, confirm that you are entitled, insofar as legally permitted, to reimbursement of legal costs in advance of the final disposition of any action against you.

## Annex A

### Definitions of 'Independent Director' (and similar terms)

Stock market definitions, applicable to all directors:

#### **New York Stock Exchange** (*commentary omitted*):

(a) No director qualifies as "independent" unless 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). Companies must identify which directors are independent and disclose the basis for that determination.

(b) In addition, a director is not independent if:

(i) the director is, or has been within the last three years, an employee of the listed company, or an immediate family member is, or has been within the last three years, an executive officer of the listed company;

(ii) the director has received, or has an immediate family member who has received, during any 12-month period within the last three years, more than \$100,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service);

(iii) (A) the director or an immediate family member is a current partner of a firm that is the company's internal or external auditor; (B) the director is a current employee of such a firm; (C) the director has an immediate family member who is a current employee of such a firm and who participates in the firm's audit, assurance or tax compliance (but not tax planning) practice; or (D) the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such a firm and personally worked on the listed company's audit within that time;

(iv) the director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serve or served on that company's compensation committee; or

(v) the director is a current employee, or an immediate family member is a current executive officer, of a company that has made payments to, or received payments from, the listed company for property or services in an amount that, in any of the last three fiscal years, exceeds the greater of \$1 million or 2% of such other company's consolidated gross revenues.

## Nasdaq Stock Market:

“Independent director” means a person other than an executive officer or employee of the company or any other individual having a relationship that, in the opinion of the company’s board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent:

(a) a director who is, or at any time during the past three years was, employed by the company;

(b) a director who accepted or who has a family member who accepted any compensation from the company in excess of \$120,000 during any period of 12 consecutive months within the three years preceding the determination of independence, other than the following:

(i) compensation for board or board committee service;

(ii) compensation paid to a family member who is an employee (other than an executive officer) of the company; or

(iii) benefits under a tax-qualified retirement plan or nondiscretionary compensation, provided, however, that in addition to the requirements contained in this paragraph (b), audit committee members are also subject to additional, more stringent requirements under Rule 4350(d).

(c) 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 as an executive officer;

(d) 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 the following:

(i) payments arising solely from investments in the company’s securities; or

(ii) payments under nondiscretionary charitable contribution matching programs.

(e) a director of the issuer who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the issuer served on the compensation committee of such other entity; or

(f) a director who is, or has a family member who is, a current partner of the company’s outside auditor, or was a partner or employee of the company’s outside auditor who worked on the company’s audit at any time during any of the past three years.

## **American Stock Exchange:**

Each issuer must have a sufficient number of independent directors on its board of directors (a) such that at least a majority of such directors are independent directors (subject to the exceptions set forth in Section 801), and (b) to satisfy the audit committee requirements set forth below.

“Independent director” means a person other than an executive officer or employee of the company. No director qualifies as independent unless the issuer’s board of directors affirmatively determines that the director does not have a relationship that would interfere with the exercise of independent judgment in carrying out the director’s responsibilities of a director. In addition to the requirement contained in this Section 803A, directors serving on audit committees must also comply with the additional, more stringent requirements set forth in Section 803(B)(2) below. The following is a nonexclusive list of persons who shall not be considered independent:

(a) a director who is, or during the past three years was, employed by the company, other than prior employment as an interim executive officer (provided the interim employment did not last longer than one year);

(b) a director who accepted or has an immediate family member who accepted any compensation from the company in excess of \$100,000 during any period of 12 consecutive months within the three years preceding the determination of independence, other than the following:

- (i) compensation for board or board committee service,
- (ii) compensation paid to an immediate family member who is an employee (other than an executive officer) of the company,
- (iii) compensation received for former service as an interim executive officer (provided the interim employment did not last longer than one year), or
- (iv) benefits under a tax-qualified retirement plan;

(c) a director who is an immediate family member of an individual who is, or has been at any time during the past three years, employed by the company as an executive officer;

(d) a director who is, or has an immediate 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 (other than those arising solely from investments in the company’s securities or payments under nondiscretionary charitable contribution matching programs) that exceed 5% of the organization’s consolidated gross revenues for that year, or \$200,000, whichever is more, in any of the most recent three fiscal years;

(e) a director who is, or has an immediate family member who is, employed as an executive officer of another entity where at any time during the most recent three fiscal years executive officers served on the compensation committee of such other entity; or

(f) a director who is, or has an immediate family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years.

### **SEC Rule 10A-3, Applicable to Audit Committee Members:**

In order to be considered independent, a member of an audit committee of a listed issuer may not, other than in his or her capacity as a member of the audit committee, the board of directors or any other board committee:

- (i) accept directly or indirectly any consulting, advisory or other compensatory fee from the issuer or any subsidiary thereof, provided that, unless the rules of the national securities exchange or national securities association provide otherwise, compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the listed issuer (provided that such compensation is not contingent in any way on continued service); or
- (ii) be an affiliated person of the issuer or any subsidiary thereof.

The term "indirect acceptance" by a member of the audit committee of any consulting, advisory or other compensatory fee includes acceptance of such a fee by a spouse; a minor child or stepchild; a child or stepchild sharing a home with the member; or an entity in which such member is a partner, member, an officer (such as a managing director occupying a comparable position, or executive officer) or occupies a similar position (except limited partners, nonmanaging members and those occupying similar positions who, in each case, have no active role in providing services to the entity) that provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary of the issuer.

### **Exchange Act Rule 16b-3(b)(3)(i), Applicable to Compensation Committee Members:**

A nonemployee director shall mean a director who:

- (i) is not currently an officer (as defined in Rule 16a-1(f)) of the issuer or a parent or subsidiary of the issuer, or otherwise currently employed by the issuer or a parent or subsidiary of the issuer;

- (ii) does not receive compensation, either directly or indirectly, from the issuer or a parent or subsidiary of the issuer for services rendered as a consultant or in any capacity other than as a director, except for an amount that does not exceed the dollar amount for which disclosure would be required pursuant to Item 404(a) of Regulation S-K;
- (iii) does not possess an interest in any other transaction for which disclosure would be required pursuant to Item 404(a) of Regulation S-K; and
- (iv) is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(b) of Regulation S-K.

**Treasury Regulation § 1.162(27)(e)(3)(i), Applicable to Compensation Committee Members:**

A director is an outside director if the director:

- (i) is not a current employee of the publicly held corporation;
- (ii) is not a former employee of the publicly held corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year;
- (iii) has not been an officer of the publicly held corporation; and
- (iv) does not receive remuneration from the publicly held corporation, either directly or indirectly, in any capacity other than as a director. For this purpose, remuneration includes any payment in exchange for goods or services.

The authors of this guide are members of Loeb & Loeb's Corporate Governance Practice Group, a multidisciplinary practice group that provides advice regarding corporate governance, transactional matters, internal/independent investigations and litigation.

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