

7, 2003, Nasdaq filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal, as amended, on an accelerated basis.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq has filed with the Commission a proposed rule change relating to amendments to its recently adopted rules regarding shareholder approval for stock option or purchase plans or other equity compensation arrangements.

The text of the proposed rule change, as amended, is below. Proposed new language is in *italics*; proposed deletions are in brackets.

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Rule 4350. Qualitative Listing Requirements for Nasdaq National Market and Nasdaq SmallCap Market Issuers Except for Limited Partnerships

(a)–(h) No change

(i) Shareholder Approval

(1) Each issuer shall require shareholder approval prior to the issuance of designated securities under subparagraph (A), (B), (C), or (D) below:

(A) when a stock option or purchase plan is to be established or materially amended or other equity compensation arrangement made or materially amended, pursuant to which options or stock may be acquired by officers, directors, employees, or consultants, except for:

(i) No change

(ii) tax qualified, non-discriminatory employee benefit plans (e.g., plans that meet the requirements of Section 401(a) or 423 of the Internal Revenue Code) or parallel nonqualified plans, provided such plans are approved by the issuer's *independent* compensation committee or a majority of the issuer's independent directors; or plans that merely provide a convenient way to purchase shares on the open market or from the issuer at fair market value; or

comprised of a majority of independent director" throughout NASD Rule 4350(i) and IM-4350-5 with the phrase "independent compensation committee." This proposed change is to conform Nasdaq's description of compensation committee to that of NYSE's description in Section 303A(8) of the NYSE's Listed Company Manual. In addition, in Amendment No. 1, Nasdaq requested accelerated approval of the proposed rule change, as amended.

⁴ See letter from John D. Nachmann, Senior Attorney, Nasdaq, to Katherine A. England, Assistant Director, Division, Commission, dated October 7, 2003 ("Amendment No. 2"). In Amendment No. 2, Nasdaq made technical corrections to the proposed rule text.

(iii) No change

(iv) issuances to a person not previously an employee or director of the company, provided such issuances are approved by either the issuer's *independent* compensation committee [comprised of a majority of independent directors] or a majority of the issuer's independent directors. *Promptly following an issuance of any employment inducement grant in reliance on this exception, a company must disclose in a press release the material terms of the grant, including the recipient(s) of the grant and the number of shares involved.*

(B)–(D) No change

(2)–(6) No change

(j)–(l) No change

IM-4350-5. Shareholder Approval for Stock Option Plans or Other Equity Compensation Arrangements

Employee ownership of company stock can be an effective tool to align employee interests with those of other shareholders. Stock option plans or other equity compensation arrangements can also assist in the recruitment and retention of employees, which is especially critical to young, growing companies, or companies with insufficient cash resources to attract and retain highly qualified employees. However, these plans can potentially dilute shareholder interests. As such, Rule 4350(i)(1)(A) ensures that shareholders have a voice in these situations, given this potential for dilution.

Rule 4350(i)(1)(A) requires shareholder approval when a plan or other equity compensation arrangement is established or materially amended. For these purposes, a material amendment would include, but not be limited to, the following:

(1) any material increase in the number of shares to be issued under the plan (other than to reflect a reorganization, stock split, merger, spinoff or similar transaction);

(2) any material increase in benefits to participants, including any material change to: (i) permit a repricing (or decrease in exercise price) of outstanding options, (ii) reduce the price at which shares or options to purchase shares may be offered, or (iii) extend the duration of a plan;

(3) any material expansion of the class of participants eligible to participate in the plan; and

(4) any expansion in the types of options or awards provided under the plan.

While general authority to amend a plan would not obviate the need for shareholder approval, if a plan permits

a specific action without further shareholder approval, then no such approval would generally be required. However, if a plan contains a formula for automatic increases in the shares available (sometimes called an "evergreen formula"), or for automatic grants pursuant to a dollar-based formula (such as annual grants based on a certain dollar value, or matching contributions based upon the amount of compensation the participant elects to defer), such plans cannot have a term in excess of ten years unless shareholder approval is obtained every ten years. However, plans that *do not contain a formula and do not impose a* [no] limit on the number of shares available for grant would require shareholder approval of each grant under the plan. A requirement that grants be made out of treasury shares or repurchased shares will not alleviate these additional shareholder approval requirements.

As a general matter, when preparing plans and presenting them for shareholder approval, issuers should strive to make plan terms easy to understand. In that regard, it is recommended that plans meant to permit repricing use explicit terminology to make this clear.

Rule 4350(i)(1)(A) provides an exception to the requirement for shareholder approval for warrants or rights offered generally to all shareholders. In addition, an exception is provided for tax qualified, non-discriminatory employee benefit plans as well as parallel nonqualified plans [1] as these plans are regulated under the Internal Revenue Code and Treasury Department regulations. *An equity compensation plan that provides non-U.S. employees with substantially the same benefits as a comparable tax qualified, non-discriminatory employee benefit plan or parallel nonqualified plan that the issuer provides to its U.S. employees, but for features necessary to comply with applicable foreign tax law, are also exempt from shareholder approval under this section.*

Further, there is an exception for inducement grants to new employees because in these cases a company has an arm's length relationship with the new employees. Inducement grants for these purposes include grants of options or stock to new employees in connection with a merger or acquisition. The rule requires that such issuances must be approved by the issuer's *independent* compensation committee or a majority of the issuer's independent directors. *The rule further requires that promptly following an issuance of any employment inducement grant in reliance on this exception, a company*