

The Exchange is proposing to adopt new CSE Rule 13.6, which would require shareholder approval of all equity-compensation plans and material revisions to such plans, subject to limited exemptions. Under the Exchange's proposal, an equity compensation plan is defined as a plan or other arrangement that provides for the delivery of equity securities (either newly issued or treasury shares) of the listed company to any employee, director or other service provider as compensation for services, including a compensatory grant of options or other equity securities that is not made under a plan. The Exchange is also proposing to provide clarification on certain plans that would not be considered equity compensation plans under this definition, such as plans that do not provide for delivery of equity securities of the issuer (e.g., plans that pay in cash) and deferred compensation plans under which employees pay full current market value for deferred shares.

In addition, the proposal provides for certain types of grants that are exempted from shareholder approval. These limited exemptions include: (1) Inducement awards to person's first becoming an employee of an issuer or any of its subsidiaries, to an issuer following a *bona fide* period of employment interruption, and for grants to new employees in connection with a merger or acquisition;⁵ (2) mergers and acquisitions, when conversions, replacements or adjustments of outstanding options or other equity compensation awards are necessary to reflect the transaction, and when shares available under certain plans acquired in corporate acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval; and (3) plans intended to meet the requirements of Section 401(a) of the Internal Revenue Code⁶ (e.g., ESOPs), plans intended to meet the requirements of Section 423 of the Internal Revenue Code,⁷ and parallel excess plans that meet certain conditions. The Exchange also proposes that, in circumstances in which equity compensation plans and

amendments to plans are not subject to shareholder approval, the plans and amendments still must be subject to the approval of the company's independent compensation committee or a majority of the company's independent directors. In addition, the Exchange proposes that an issuer must notify the Exchange in writing when it uses any of the exemptions from the shareholder approval requirements.

The Exchange is also proposing to provide a non-exclusive list of "material revisions" to a plan that would require shareholder approval. Within this list of revisions, the Exchange proposes to define the concepts of "evergreen plans" (i.e., plans that contain a formula for automatic increases in the shares available), "formula plans" (i.e., plans that provide for automatic grants pursuant to a formula), and "discretionary plans" (i.e., plans that contain no limit on the number of shares available and plans that are not formula plans). The Exchange proposes that each grant under a discretionary plan require shareholder approval regardless of whether the plan has a term of not more than 10 years.

Shareholder approval will be required for plans adopted before the effective date of these proposed amendments that have not been approved by shareholders and have neither an evergreen formula nor a specific number of shares available under the plan. The Exchange is proposing to provide transition rules to clarify when shareholder approval will be required for these pre-existing plans. In addition, during the period prior to the approval, pre-existing plans may be utilized, but only in a manner consistent with past practice. The transition rules provide that an evergreen plan that was approved by shareholders but does not have a ten-year term must be: (1) Approved by shareholders before any shares that become available as a result of a formulaic increase are utilized, or (2) amended to include a term of no more than ten years from the date the plan was adopted or last approved by shareholders. If the plan were amended to include such term, shareholder approval would not be required. No action would be required, however, if a plan were frozen at the level of shares available at the time the rule becomes effective. The transition rules also provide that repricings that have commenced prior to the effectiveness of the proposal (i.e., exchange offers to optionees) will not be subject to shareholder approval (assuming that such repricing would not require shareholder approval under other Exchange By-Laws or Rules).

Finally, the Exchange is also proposing to amend CSE Rule 13.3 to prohibit members from voting on equity compensation plans unless the beneficial owner of the shares has given voting instructions. The Exchange proposes a transition period that will make these provisions of CBOE Rule 13.3 applicable only to shareholder meetings that occur on or after the 90th day following the date of the Commission order approving the rule.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6 of the Act,⁸ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁹ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

notice of File No. SR-NASD-2003-130. See Securities Exchange Act Release No. 48627A (October 22, 2003), 68 FR 61532 (October 28, 2003). The Commission notes that these additional amendments by Nasdaq make the NYSE and Nasdaq proposals more consistent and uniform. See also *infra* note (regarding the Commission's recent approval of a similar proposal by the American Stock Exchange LLC ("Amex")).

⁵ The Exchange is also proposing to include a requirement that listed companies provide prompt public disclosure following the grant of any inducement award in reliance on the exemption.

⁶ 26 U.S.C. 401(a).

⁷ 26 U.S.C. 423.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).