**October 2, 2003**

**The proposed text of NASDAQ's rule changes relating to independent boards and committees appears below. Proposed new language is underlined; proposed deletions are in brackets. Please note that this text has not been formally filed with the SEC and remains subject to change.**

**Rule 4200. Definitions**

(a) For purposes of the Rule 4000 Series, unless the context requires otherwise:

(1) – (13) No change.

(14) "Family Member" means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

(15) "Independent director" means a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship, which, 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 [corporation] company or by any parent or subsidiary of the company [any of its affiliates for the current year or any of the past three years];

(B) a director who accept[s]ed or who has a Family Member who accepted any [compensation] payments from the [corporation] company or any [of

its affiliates] parent or subsidiary of the company in excess of $60,000 during the current or any of the past three fiscal years [previous fiscal year], other than the following:

(i) compensation for board or board committee service [,];

(ii) payments arising solely from investments in the company's securities;

(iii) compensation paid to a Family Member who is a non-executive employee of the company or a parent or subsidiary of the company;

(iv) benefits under a tax-qualified retirement plan, or non-discretionary compensation; or

(v) loans permitted under Section 13(k) of the Act.

Provided, however, that audit committee members are subject to additional, more stringent requirements under Rule 4350(d).

(C) a director who is a [member of the immediate] [f]Family Member of an individual who is, or [has been in any of] at any time during the past three years was, employed by the [corporation] company or by any [of its affiliates] parent or subsidiary of the company as an executive officer[. Immediate family includes a person's spouse, parents, children, siblings, mother-in-law, father-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law, and anyone who resides in such person's home];

(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 [for-profit business]

organization to which the [corporation] company made, or from which the [corporation] company received, payments for property or services in the current or any of the past three fiscal years [(other than those arising solely from investments in the corporation's securities)] that exceed 5% of the recipient's [corporation's or business organization's] consolidated gross revenues for that year, or $200,000, whichever is more, [in any of the past three years;] other than the following:

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

(ii) payments under non-discretionary charitable contribution matching programs.

(E) a director of the listed company 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 [company's] executive[s] officers of the listed company serve on [that entity's] 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.

Former (15) – (37) renumbered as (16) – (38).

**IM – 4200 Definition of Independence - Rule 4200(a)(15)**

It is important for investors to have confidence that individuals serving as

independent directors do not have a relationship with the listed company that would impair their independence. The board has a responsibility to make an affirmative determination that no such relationships exist through the application of Rule 4200. Rule 4200 also provides a list of certain relationships that preclude a board finding of independence. These objective measures provide transparency to investors and companies, facilitate uniform application of the rules, and ease administration. Because Nasdaq does not believe that ownership of company stock by itself would preclude a board finding of independence, it is not included in the aforementioned objective factors. It should be noted that there are additional, more stringent requirements that apply to directors serving on audit committees, as specified in Rule 4350.

The Rule's reference to a "parent or subsidiary" is intended to cover entities the issuer controls and consolidates with the issuer's financial statements as filed with the U.S. Securities and Exchange Commission (but not if the issuer reflects such entity solely as an investment in its financial statements). The reference to executive officer has the same meaning as the definition in Rule 16a-1(f) under the Act.

The three year look-back periods referenced in paragraphs (A), (C), (E) and (F) of the Rule commence on the date the relationship ceases. For example, a director employed by the company is not independent until three years after such employment terminates.

Paragraph (B) of the rule is generally intended to capture situations where a payment is made directly to (or for the benefit of) the director or a family member of the director. For example, consulting or personal service contracts with a director or family member of the director or political contributions to the campaign of a director or a family member of the director would be considered under paragraph (B) of the rule.

Paragraph (D) of the rule is generally intended to capture payments to an entity with which the director or Family Member of the director is affiliated by serving as a partner, controlling shareholder or executive officer of such entity. Under exceptional circumstances, such as where a director has direct, significant business holdings, it may be appropriate to apply the corporate measurements in paragraph (D), rather than the individual measurements of paragraph (B). Issuers should contact Nasdaq if they wish to apply the rule in this manner. The reference to a partner in paragraph (D) is not intended to include limited partners. It should be noted that the independence requirements of paragraph (D) of the rule are broader than Rule 10A-3(e)(8) under the Act.

Under paragraph (D), a director who is, or who has a Family Member who is, an executive officer of a charitable organization may not be considered independent if the company makes payments to the charity in excess of the greater of the greater of 5% of the charity's revenues or $200,000. However, Nasdaq encourages companies to consider other situations where a director or their Family Member and the company each have a relationship with the same charity when assessing director independence.

For purposes of determining whether a lawyer is eligible to serve on an audit committee, Rule 10A-3 under the Act generally provides that any partner in a law firm that receives payments from the issuer is ineligible to serve on that issuer's audit committee. In determining whether a director may be considered independent for purposes other than the audit committee, payments to a law firm would generally be considered under Rule 4200(a)(15)(D), which looks to whether the payment exceeds the greater of 5% of the recipients gross revenues or $200,000; however, if the firm is a sole proprietorship, Rule 4200(a)(15)(B), which looks to whether the payment exceeds $60,000, applies.

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

(a) – (b) No change.

**(c) Independent Directors**

[Each issuer shall maintain a sufficient number of independent directors on its board of directors to satisfy the audit committee requirement set forth in Rule 4350(d)(2).]

(1) A majority of the board of directors must be comprised of independent directors as defined in Rule 4200. The company must disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board of directors has determined to be independent under Rule 4200. If an issuer fails to comply with this requirement due to one vacancy, or one director ceases to be independent due to circumstances beyond their reasonable control, the issuer shall regain compliance with the requirement by the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision shall provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

(2) Independent directors must have regularly scheduled meetings at which only independent directors are present ("executive sessions").

(3) Compensation of Officers

(A) Compensation of the chief executive officer of the company must be determined or recommended to the Board for determination either by:

(i) a majority of the independent directors voting in executive session, or

(ii) a compensation committee comprised solely of independent directors voting in executive session.

(B) Compensation of all other officers, as that term is defined in Rule 16a-1(f) under the Act, must be determined or recommended to the Board for determination either by:

(i) a majority of the independent directors voting in executive session, or

(ii) a compensation committee comprised solely of independent directors, voting in executive session.

The chief executive officer may be present during such deliberations, but may not be present during voting.

(C) Notwithstanding paragraphs (3)(A)(ii) and (3)(B)(ii) above, if the compensation committee is comprised of at least three members, one director who is not independent as defined in Rule 4200 and is not a current officer or employee or a Family Member of officer or employee, may be appointed to the compensation committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for the next annual meeting subsequent to such determination

(or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.

(4) Nomination of Directors

(A) Director nominees must either be selected or recommended for the Board's selection by:

(i) a majority of the independent directors, voting in executive session, or

(ii) a nominations committee comprised solely of independent directors, voting in executive session.

(B) Each issuer must certify that it has adopted a formal written charter addressing the nominations process and such related matters as may be required under the federal securities laws.

(C) Notwithstanding paragraph (4)(A)(ii) above, if the nominations committee is comprised of at least three members, one director, who is not independent as defined in Rule 4200 and is not a current officer or employee or a Family Member of such officer or employee, may be appointed to the nominations committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its

shareholders, and the board discloses, in the proxy statement for next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.

(D) Independent Director oversight of director nominations shall not apply in cases where the right to nominate a director legally belongs to a third party. However, this does not relieve a company's obligation to comply with the committee composition requirements under Rule 4350(c) and (d).

(E) This Rule 4350(c)(4) is not applicable to a company if the company is subject to a binding obligation that requires a director nomination structure inconsistent with this rule and such obligation pre-dates [insert approval date of rule].

(5) A Controlled Company is exempt from the requirements of this Rule 4350(c), except for the requirements of subsection (c)(2) which pertain to executive sessions of independent directors. A Controlled Company is a company of which more than 50% of the voting power is held by an individual, a group or another company. A Controlled Company relying upon this exemption must disclose in its annual meeting proxy statement (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) that it is a Controlled Company and the basis for that determination.

**(d) Audit Committee**

(1) Audit Committee Charter

Each issuer must certify that it has adopted a formal written audit committee charter and that the audit committee has reviewed and reassessed the adequacy of the formal written charter on an annual basis. The charter must specify [the following]:

(A) – (B) No change.

(C) [the outside auditor's ultimate accountability to the board of directors and the audit committee, as representatives of shareholders, and these shareholder representatives' ultimate authority and responsibility to select, evaluate, and, where appropriate, replace the outside auditor (or to nominate the outside auditor to be proposed for shareholder approval in any proxy statement)] the committee's purpose of overseeing the accounting and financial reporting processes of the issuer and the audits of the financial statements of the issuer;

(D) the specific audit committee responsibilities and authority set forth in Rule 4350(d)(3).

(2) Audit Committee Composition

(A) Each issuer must have, and certify that it has and will continue to have, an audit committee of at least three members, [comprised solely of independent directors] each of whom [is] must:

(i) be independent as defined under Rule 4200(a)(15); (ii) meet the criteria for independence set forth in Rule 10A-3(b)(1) under the Act (subject to the exemptions provided in Rule 10A-3(c)); (iii) not have participated in the preparation of the financial statements of the company or any current subsidiary of the company at any time during the past three years; and (iv) be able to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement [or will become able to do so within a reasonable period of time after his or her appointment to the audit committee]. Additionally, each issuer must certify that it has, and will continue to have, at least one member of the audit committee [that] who has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(B) Notwithstanding paragraph (2)(A)(i), one director who:

(i) is not independent as defined in Rule 4200; (ii) meets the criteria set forth in Section 10A(m)(3) under the Act and the rules thereunder;[,] and (iii) is not a current officer or employee or a[n immediate] F[f]amily M[m]ember of such officer or employee, may be appointed to the audit committee, if the board, under exceptional and limited circumstances,

determines that membership on the committee by the individual is required by the best interests of the [corporation] company and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for that determination. A member appointed under this exception may not serve longer than two years and may not chair the audit committee.

[(C) Exception for Small Business Filers - Paragraphs (2)(A) and (2)(B) do not apply to issuers that file reports under SEC Regulation S-B. Such issuers must establish and maintain an Audit Committee of at least two members, a majority of the members of which shall be independent directors.]

(3) Audit Committee Responsibilities and Authority

The Audit Committee must have the specific audit committee responsibilities and authority necessary to comply with Rule 10A-3(b)(2), (3), (4) and (5) under the Act (subject to the exemptions provided in Rule 10A-3(c)), concerning responsibilities relating to: (i) registered public accounting firms, (ii) complaints relating to accounting, internal accounting controls or auditing matters, (iii) authority to engage advisors, and (iv) funding as determined by the audit committee.

(4) Cure Periods

(A) If an issuer fails to comply with the audit committee composition requirement under 10A-3(b)(1) under the Act and Rule 4350(d)(2)

because an audit committee member ceases to be independent for reasons outside the member's reasonable control, the audit committee member may remain on the audit committee until the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision must provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

(B) If an issuer fails to comply with the audit committee composition requirement under Rule 4350(d)(2)(A) due to one vacancy on the audit committee, and the cure period in paragraph (A) is not otherwise being relied upon for another member, the issuer will have until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision must provide notice to Nasdaq immediately upon learning of the event or circumstance that caused the non-compliance.

(e) – (l) No change.

(m) An issuer must provide Nasdaq with prompt notification after an executive officer of the issuer becomes aware of any material noncompliance by the issuer with the requirements of this Rule 4350.

**IM-4350-4 Board Independence and Independent Committees**

**Independent Directors and Independent Committees – Rule 4350(c)**

**Majority Independent Board.** Independent directors (as defined in Rule 4200(A)(15)) play an important role in assuring investor confidence. Through the exercise of independent judgment, they act on behalf of investors to maximize shareholder value in the companies they oversee and guard against conflicts of interest. Requiring that the board be comprised of a majority of independent directors empowers such directors to carry out more effectively these responsibilities.

**Executive Sessions of Independent Directors.** Regularly scheduled executive sessions encourage and enhance communication among independent directors. It is contemplated that executive sessions should occur at least twice a year, and perhaps more frequently, in conjunction with regularly scheduled board meetings.

**Independent Director Oversight of Executive Compensation.** Independent director oversight of executive officer compensation helps assure that appropriate incentives are in place, consistent with the board's responsibility to maximize shareholder value. The Rule is intended to provide flexibility for an issuer to choose an appropriate board structure and to reduce resource burdens, while ensuring independent director control of compensation decisions.

**Independent Director Oversight of Director Nominations.** Independent director oversight of nominations enhances investor confidence in the selection of well-qualified director nominees, as well as independent nominees as required by the Rules. This Rule is also intended to provide flexibility for a company to choose an appropriate board structure and reduce resource burdens, while ensuring that independent directors approve all nominations.

This Rule does not apply in cases where the right to nominate a director legally belongs to a third party. For example, investors may negotiate the right to nominate directors in connection with an investment in the company, holders of preferred stock may be permitted to nominate or appoint directors upon certain defaults, or the company may be a party to a shareholder's agreement that allocates the right to nominate some directors. Because the right to nominate directors in these cases does not reside with the company, independent director approval would not be required. This Rule is not applicable if the company is subject to a binding obligation that requires a director nomination structure inconsistent with the Rule and such obligation pre-dates [insert approval date of rule] , the approval date of this rule.

**Controlled Company Exemption.** This exemption recognizes that majority shareholders, including parent companies, have the right to select directors and control certain key decisions, such as executive officer compensation, by virtue of their ownership rights. In order for a group to exist for purposes of this Rule, the shareholders must have publicly filed a notice that they are acting as a group (e.g., a Schedule 13D). A Controlled Company not relying upon this exemption need not provide any special disclosures about its controlled status. It should be emphasized that this controlled company exemption does not extend to the audit committee requirements under Rule 4350(d) or the requirement for executive sessions of independent directors under Rule 4350(c)(2).

**Audit Committees – Rule 4350(d)**

**Audit Committee Charter.** Each issuer is required to adopt a formal written charter that specifies the scope of its responsibilities and the means by which it carries out those responsibilities; the outside auditor's accountability to the audit committee; and the audit

committee's responsibility to ensure the independence of the outside auditor. Consistent with this, the charter must specify all audit committee responsibilities set forth in Rule 10A-3(b)(2), (3), (4) and (5) under the Act. Rule 10A-3(b)(3)(ii) requires that each audit committee must establish procedures for the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters. For purposes of Rule 4350(d)(1)(D), audit committees for registered management investment companies must also establish such procedures for the confidential, anonymous submission by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company. Such procedures must be set forth in the audit committee charter.

The rights and responsibilities as articulated in the audit committee charter empower the audit committee and enhance its effectiveness in carrying out its responsibilities.

**Audit Committee Composition.** Audit committees are required to have a minimum of three members and be comprised only of independent directors. In addition to satisfying the independent director requirements under Rule 4200, audit committee members must meet the criteria for independence set forth in Rule 10A-3(b)(1) under the Act (subject to the exemptions provided in Rule 10A-3(c)): they must not accept any consulting, advisory, or other compensatory fee from the company other than for board service, and they must not be an affiliated person of the company. It is recommended that an issuer disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F ) if any director is deemed independent but falls outside the safe harbor provisions of Rule 10A-3(e)(1)(ii) under the Act. A director who qualifies as an audit committee financial expert under Item 401(h) of Regulation S-

K or Item 401(e) of Regulation S-B is presumed to qualify as a financially sophisticated audit committee member under Rule 4350(d)(2)(A).

**The Audit Committee Responsibilities and Authority.** Audit Committees must have the specific audit committee responsibilities and authority necessary to comply with Rule 10A-3(b)(2), (3), (4) and (5) under the Act (subject to the exemptions provided in Rule 10A-3(c)), concerning responsibilities relating to registered public accounting firms; complaints relating to accounting; internal accounting controls or auditing matters; authority to engage advisors; and funding.