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March 24, 2003

Katherine A. England, Esq.  
Assistant Director  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: **File No. SR-NASD-2002-140; Amendment No. 2**  
Shareholder Approval Requirements Under Rule 4350(i)

Dear Ms. England:

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and Rule 19b-4 thereunder, the National Association of Securities Dealers, Inc. ("NASD"), through The Nasdaq Stock Market, Inc. ("Nasdaq"), its subsidiary, wishes to make the following amendment to its rule proposal in the above-captioned rule filing:

1) The text of Rule 4350(i)(1)(A)(ii), which appears on page 4 and 17 of the original rule filing, should read as follows:

(ii) [broadly based plans or arrangements including other employees (e.g. ESOPs).] 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 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

2) The text of IM 4350-5, which appears on page 5 and 18 of the original rule filing, should read as follows:

**IM-4350-5. Shareholder Approval for Stock Option Plans or Other**

**Arrangements**

Employee ownership of company stock can be an effective tool to align employee interests with those of other shareholders. Stock option plans 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 the use of stock option plans, given this potential for dilution.

Rule 4350(i)(1)(A) requires shareholder approval of material amendments to plans. The following is a non-exclusive list of plan amendments that are considered material, and as such, would require shareholder approval: (1) any 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 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, (iii) increase the number of shares that may be granted or sold under the plan, or (iv) extend the duration of a plan; (3) any expansion of the class of participants eligible to

participate in the plan; and (4) any change 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 be required.

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 that 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<sup>1</sup> as these plans are regulated under the Internal Revenue Code and Treasury Department regulations.

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, and its interests are directly aligned with the shareholders. Inducement grants for these purposes include grants of options or stock to new employees in connection with a merger or acquisition.

In addition, plans involving a merger or acquisition do not require shareholder approval in two situations. First, shareholder approval will not be required to convert, replace or adjust outstanding options or other equity

compensation awards to reflect the transaction. Second, shares available under certain plans acquired in acquisitions and mergers may be used for certain post-transaction grants without further shareholder approval. This exception applies to situations where the party which is not a listed company following the transaction has shares available for grant under pre-existing plans that were previously approved by shareholders. These shares may be used for post-transaction grants of options and other equity awards by the listed company (after appropriate adjustment of the number of shares to reflect the transaction), either under the pre-existing plan or another plan, without further shareholder approval, so long as (1) the time during which those shares are available for grants is not extended beyond the period when they would have been available under the pre-existing plan, absent the transaction, and (2) such options and other awards are not granted to individuals who were employed by the granting company at the time the merger or acquisition was consummated. Nasdaq would view a plan adopted in contemplation of the merger or acquisition transaction as not pre-existing for purposes of this exception. This exception is appropriate because it will not result in any increase in the aggregate potential dilution of the combined enterprise.<sup>2</sup>

Inducement grants, tax qualified non-discriminatory benefit plans, and parallel nonqualified plans are subject to approval by either the issuer's compensation committee, or a majority of the issuer's independent directors. It should also be noted that a company would not be permitted to use repurchased shares to fund option plans or grants without prior shareholder approval.

Footnotes to IM-4350-5:

<sup>1</sup> The term “parallel nonqualified plan” means a plan that is a “pension plan” within the meaning of the Employee Retirement Income Security Act (“ERISA”), 29 U.S.C. §1002 (1999), that is designed to work in parallel with a plan intended to be qualified under Internal Revenue Code Section 401(a), to provide benefits that exceed the limits set forth in Internal Revenue Code Section 402(g) (the section that limits an employee’s annual pre-tax contributions to a 401(k) plan), Internal Revenue Code Section 401(a)(17) (the section that limits the amount of an employee’s compensation that can be taken into account for plan purposes) and/or Internal Revenue Code Section 415 (the section that limits the contributions and benefits under qualified plans) and/or any successor or similar limitations that may thereafter be enacted. However, a plan will not be considered a parallel nonqualified plan unless (i) it covers all or substantially all employees of an employer who are participants in the related qualified plan whose annual compensation is in excess of the limit of Code Section 401(a)(17) (or any successor or similar limitation that may hereafter be enacted) and (ii) its terms are substantially the same as the qualified plan that it parallels except for the elimination of the limitations described in the preceding sentence.

<sup>2</sup> Note that any such shares reserved for listing in connection with the transaction would be counted by Nasdaq in determining whether the transaction involved the issuance of 20% or more of the company’s outstanding common stock and thus required shareholder approval under Rule 4350(i)(1)(D).

3) The first full paragraph and second paragraph of the Purpose Section, which appears on pages 11 and 23 of the original rule filing, should read as follows:

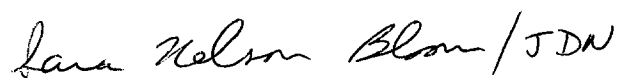
Under the proposed Rule, inducement grants, tax qualified, non-discriminatory benefit plans, and parallel nonqualified plans are subject to approval by either the issuer's compensation committee, or a majority of the issuer's independent directors. It should also be noted that a company would not be permitted to use repurchased shares to fund options without prior shareholder approval. However, Plans that merely provide a convenient way to purchase shares on the open market or from the issuer at fair market value would not require shareholder approval.

The rule also clarifies that material amendments to plans will require shareholder approval. The accompanying Interpretative Material also provides a non-exclusive list of plan amendments that are considered material, and clarifies that 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 be required. The Interpretative Material also observes that 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 that permit repricing use explicit terminology to make this clear.

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Nasdaq believes that these amendments are consistent with the Exchange Act for the reasons outlined in its original filing with the Commission. If you have any questions, please feel free to contact me at (202) 912-3032.

Very truly yours,

A handwritten signature in black ink that reads "Sara Nelson Bloom / JDN". The signature is written in a cursive style.

Sara Nelson Bloom

cc: Sapna Patel