**Duties and Obligations of Nasdaq Directors:**
**Prepared for the Board of Directors of**
**Nasdaq, Inc. and Self-Regulatory Organization Subsidiaries Thereof**

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## I. INTRODUCTION

This briefing paper is intended to provide background information to members of the Board of Directors (the "Board") of Nasdaq, Inc. ("Nasdaq") regarding their duties and obligations as Directors. The information is also relevant to the Directors of Nasdaq's self-regulatory organization ("SRO") subsidiaries. Thus, references to Nasdaq and its Board and Directors should generally also be understood as relevant to the SRO subsidiaries and their Boards and Directors. We have tried to present the information in a plain-English format, omitting most citations to statutes, regulations, and case law. Detailed information on the relevant legal authorities is available on request.

The management of Nasdaq is under the direction of the Board, but the Board generally is not involved in its day-to-day operations. The Board selects a chief executive officer, who is responsible for management and administration on a day-to-day basis, and other senior managers. As discussed in greater detail below, the Board is not required to attend to the daily operations of Nasdaq, and is entitled to rely on the management it has selected, as long as the Board reasonably believes that the actions and recommendations of management warrant confidence. However, the Board must remain informed and must investigate and act if there is reason to suspect that management is not vigilant, or is not acting in the corporation's best interest.

The discussion that follows is not intended to be exhaustive or to provide answers to any specific issues that may arise in a particular case. It does, however, set forth basic principles and concerns with which Directors should be generally familiar.

## II. DIRECTORS' REGULATORY OBLIGATIONS

Nasdaq's primary SEC-regulated U.S. subsidiaries are The Nasdaq Stock Market LLC (the "Nasdaq Exchange"), Nasdaq PHLX LLC, Nasdaq BX, Inc., Nasdaq ISE, LLC, Nasdaq GEMX, LLC, and Nasdaq MRX, LLC, which as SROs, have authority to develop and adopt rules, to operate markets, and to discipline members.[1] Under Sections 19(g) and 19(h) of the Securities Exchange Act of 1934 (the "Exchange Act"), an SRO is required to: 1) comply with the provisions of the Exchange Act, the rules and regulations promulgated thereunder, and its own rules (collectively, the "Governing Rules"); and 2) enforce compliance with the Governing Rules by its members and persons associated with its members. If the SEC finds that the SRO has violated or is unable to comply with any of the Governing Rules, or without

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1 Although they are currently dormant, Boston Stock Exchange Clearing Corporation and Stock Clearing Corporation of Philadelphia are also registered SROs.

reasonable justification or excuse has failed to enforce compliance with any of the Governing Rules, the SEC may suspend or impose limitations on the activities, functions, and operations of the SRO. Further, the SEC may remove from office or censure any SRO officer or director the SEC finds has: willfully violated any provision of the securities laws or SRO rules;[2] willfully abused his or her authority; or failed, without reasonable justification or excuse, to enforce compliance with the securities laws or SRO rules. Under Nasdaq's By-Laws, which are subject to SEC review, to the extent they are related to the activities of an SRO subsidiary, the books, records, premises, officers, Directors, and employees of Nasdaq are deemed to be the books, records, premises, officers, Directors, and employees of the SRO subsidiary for the purposes of, and subject to oversight pursuant to, the Exchange Act. Accordingly, Nasdaq must act in a manner consistent with the provisions of the Exchange Act applicable to SROs.

Sections 19(g) and 19(h) were added to the Exchange Act in 1975 in response to regulatory lapses that occurred from 1968 through 1970, when some exchanges failed to compel strict adherence to financial responsibility requirements. In adopting Sections 19(g) and 19(h), Congress sought to address SRO enforcement lapses by granting the SEC the power to compel SROs to adhere to the requirements of their rules. Congress intended that expanding the SEC's enforcement powers would increase the agency's willingness to take formal action when needed to ensure adequate SRO performance.

Nasdaq Futures, Inc., is a designated contract market ("DCM") regulated by the Commodity Futures Trading Commission ("CFTC"). To obtain and maintain its designation, a DCM must comply, on an ongoing basis, with twenty-three Core Principles established in Section 5(d) of the Commodity Exchange Act and Part 38 of the CFTC's regulations and with the implementing regulations under Part 38 of the CFTC's regulations. The CFTC's Division of Market Oversight's Examinations Branch conducts regular reviews of each DCM's ongoing compliance with core principles and the implementing regulations under Part 38, examining the self-regulatory programs operated by the exchange in order to enforce its rules, prevent market manipulation and customer and market abuses, and ensure the recording and safe storage of trade information, among other requirements. These reviews are known as rule enforcement reviews.

In addition, Nasdaq is the controller of exchanges and other regulated entities in various international jurisdictions. Accordingly, the Nasdaq Board has an obligation to ensure that the structure and resources of the company enable these regulated entities to meet their license requirements.

**SEC Actions Against SROs**

The SEC has found SROs to have engaged in violations of Section 19(g) on several occasions, and has also found SRO officers to have violated Section 19(h). The types of conduct that have prompted the SEC to take action are varied, as indicated below. In general, however, the cases were brought in response to ongoing patterns of conduct or because the SRO's procedures were inadequate to permit prompt detection of misconduct. In some cases, SRO disciplinary bodies failed to take disciplinary action

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2 In this context, "willfully" means intentionally committing the violative act. The person committing the violative act need not be aware that the action is unlawful.

when warranted, or members of the SRO's disciplinary decisional body were tainted or otherwise subject to improper influences.

- In 1980, the SEC brought a proceeding against the Philadelphia Stock Exchange for failing to enforce compliance with SEC and exchange quotation rules, as well as various exchange rules governing options position limits, option spread parameters, and options traders. The violations had occurred on an ongoing basis for several months, with the knowledge of exchange staff. Although staff undertook some efforts to bring about compliance, these efforts were not pursued vigorously, and the exchange delayed bringing disciplinary action despite evidence of ongoing violations.

- In 1980, the SEC brought a proceeding against the Boston Stock Exchange ("BSE") and its clearing corporation for failing to employ adequate surveillance procedures and to timely identify practices that resulted in violations of margin, net capital, and record-keeping requirements. The conduct occurred on an ongoing basis for approximately 13 months. When exchange officials became aware of the violations, the exchange conducted an investigation, took disciplinary action, and undertook enhanced surveillance procedures. Although the exchange ultimately sanctioned three members of the BSE Board of Governors, each of the sanctioned Governors was thereafter reelected to the BSE Board, and served on BSE committees.

- In 1989, the SEC brought a proceeding against the Chicago Board Options Exchange ("CBOE") for failing to enforce compliance with CBOE rules. The SEC's action stemmed from the failure of the CBOE's Business Conduct Committee ("BCC") to initiate disciplinary action in response to evidence that certain options trading had been conducted to create the appearance of activity. Evidence that CBOE staff presented to the BCC indicated a pattern of trading abuses by 12 market makers, including the CBOE's Vice Chairman. The conduct had occurred over a protracted period, and apparently had been undertaken for competitive reasons (*i.e.,* to induce the purchase and sale of dually traded options on the CBOE rather than at a competing marketplace).

- In 1996, the SEC initiated a proceeding against the NASD for failing to take adequate action in response to various abusive practices by certain Nasdaq market makers, and failing to apply membership criteria in an even-handed manner. The allegations that formed the basis for the SEC's action against the NASD were detailed in a lengthy report that was issued pursuant to Section 21(a) of the Exchange Act. The NASD settled the action by agreeing to comply with 14 undertakings that set forth detailed requirements governing the NASD's corporate structure and operations. The NASD also agreed to spend $100 million over five years to enhance its systems for market surveillance, including the development and implementation of enhanced audit trail, surveillance, enforcement, and internal audit functions.

- In 1997, the SEC initiated proceedings against Stock Clearing Corporation of Philadelphia ("SCCP") and Philadelphia Depository Trust Corporation ("Philadep"). Also named were two officers of SCCP and Philadep. The proceedings concerned several instances in which SCCP and/or Philadep, without SEC approval, had implemented operational modifications that constituted rule amendments. Because SRO rule amendments must be approved by the SEC, SCCP and Philadep had violated the Exchange Act in failing to seek SEC approval for the rule amendments. In addition, because SCCP and Philadep's actual practices deviated from their existing rules (which had been approved by the SEC), the SROs had violated the Exchange Act by failing to comply with those existing rules. The SEC charged that officers had known of the SROs' noncompliance, possessed authority to ensure compliance, and thus had caused the SROs' violations.

- In 2000, the SEC brought a proceeding against the American Stock Exchange, the CBOE, the Pacific Exchange, and the Philadelphia Stock Exchange (collectively, the "Options Exchanges") for engaging in conduct that impeded multiple listings of stock options and for failing to enforce members' compliance with exchange rules relating to, among other things, the handling of customer orders and the reporting of trades. The Options Exchanges settled the action by agreeing to comply with detailed undertakings relating to audit trails, listing requirements, order handling, trade reporting, and other matters.

- In 2005, the SEC initiated proceedings against the New York Stock Exchange (the "NYSE") for failure to monitor and police specialist trading activity, thereby allowing the NYSE specialists to engage in unlawful interpositioning and trading ahead. As a result, the NYSE agreed to subject its regulatory activities to an independent regulatory auditor until 2011, at a cost of $20 million and to adopt numerous enhancements to its surveillance systems, the cost of which were not specified in the SEC's Order.

- In 2005, the SEC initiated proceedings against the National Stock Exchange ("NSX") for failure to enforce a rule requiring NSX dealers to offer price improvement to customer orders in certain circumstances. The NSX agreed to a range of remedial measures, including agreeing to subject its regulatory activities to an independent auditor and to eliminate any involvement in regulatory matters on the part of its President and CEO. The SEC also censured the President and CEO.

- In 2005, the SEC issued a 21(a) Report regarding the Nasdaq Exchange's predecessor, The NASDAQ Stock Market, Inc., and its oversight by the NASD. Although the SEC did not take any enforcement action in connection with the Report, the Report emphasized the obligations of all persons associated with an SRO to fulfill regulatory obligations by referring potential regulatory violations to the Office of General Counsel for further referral to the NASD or the SEC. The Report also emphasized the importance of consistent enforcement of rules that establish fees and charges, to ensure that SROs do not display favoritism to particular customers.

- In 2007, the SEC initiated and settled proceedings against the American Stock Exchange ("Amex") and one of its compliance officers for failure to enforce a range of rules relating to its specialists. As a result, Amex undertook to retain an independent auditor to review and report on its surveillance functions for the next three years. The SEC also initiated an ultimately unsuccessful proceeding against the former CEO of Amex.

- In 2012, the SEC initiated and settled proceedings against NYSE and its parent corporation, NYSE Euronext, alleging that the respondents had architected their market data distribution systems in a manner that allowed data from proprietary data products to leave NYSE systems before comparable data going to the public tape, and had failed to maintain processes that would enable it to find the existence of this disparity. As a result, the SEC found that the respondents had violated an SEC rule governing data distribution, record-keeping obligations, and the SRO's overarching obligation to comply with SEC rules. The settlement included a fine of $5 million (the first ever against an SRO) and requirements to undertake independent reviews of NYSE's systems and procedures.

- In 2013, the SEC initiated and settled proceedings against the Nasdaq Exchange and its routing broker/dealer subsidiary relating to the Facebook initial public offering ("IPO"). The SEC alleged that the system difficulties experienced by the Nasdaq Exchange during the IPO resulted in certain violations of SRO and SEC rules, including rules requiring the processing of orders in price/time priority and the rule governing the net capital requirements of broker/dealers, and also cited system issues on other occasions that had resulted in trades in contravention of Regulation SHO and Regulation NMS. The SEC also cited the absence from Nasdaq Exchange rules of specific authorization for certain actions taken during the IPO, such as providing an extension of the period for order entry at the request of the underwriter and the use of an error account (for which a rule change was pending but not yet approved). The SEC fined the Nasdaq Exchange $10 million and imposed requirements for changes to the Nasdaq Exchange's processes for managing changes to its trading system.

- Also in 2013, the SEC initiated and settled proceedings against CBOE and its sister exchange, C2, focused on the failure adequately to enforce SEC Regulation SHO against its members. Notably, in a circumstance where the SEC was investigating a member firm, the respondents actively assisted the member firm in its efforts to defend itself, thereby compromising its regulatory independence. The respondents were also cited for engaging in a range of actions not specifically permitted under their rules. The respondents were fined $6 million and required to engage in a burdensome and expensive set of reviews and undertakings designed to improve their regulatory program and mitigate the potential for conflicts of interest.

- In 2014, the SEC sanctioned NYSE and several of its affiliated exchanges with respect to a range of activities for which the exchanges had not submitted rule filings in a timely fashion. The SEC assessed a fine of $4.5 million and required the retention of a consultant to advise on the adoption of additional procedures to determine when a particular change to business practices requires the submission of a rule filing.

- In 2015, the SEC sanctioned the EDGA Exchange and EDGX Exchange with respect to the accuracy and completeness of its rules governing order types. The exchanges were fined $14.5 million and required to conduct an exhaustive review of their order type rules. The Commission also retained the discretion to require the exchanges to hire a consultant to review their rules in the future.

- In 2018, the SEC sanctioned NYSE, NYSE American and NYSE Arca relating, among other things, to a series of trading events that occurred in 2015. The SEC alleged violations of: the anti-fraud provisions of the Securities Act because the exchanges represented their quotations were automated during a period when they were having connectivity issues; the Exchange Act because of NYSE Arca's application of price collars to reopening auctions following a trading event when NYSE Arca did not have rules that allowed for such collars; the NYSE Arca Rules, the CTA Plan and Regulation NMS because NYSE Arca accidentally implemented a 20 minute market-wide regulatory halt when it did not have authority to do so; Regulation SCI's business continuity and disaster recovery requirements for reliance on NYSE Arca's back-up systems to trade NYSE- and NYSE American-listed symbols in the event the primary market went down; and the Exchange Act by having an order type that created the possibility of detecting the presence of same side non-displayed depth liquidity, without fully disclosing that potential behavior in its effective rules. NYSE agreed to pay $14 million and was for the next three years required to provide a CEO certification as to compliance with the undertakings in the Order.

Sanctions imposed in the above-described actions have typically included requirements that the SROs make extensive revisions to their organizational structure, resource commitments, programs, policies, and procedures. During the 1990s and 2000s, the trend had been to require settling SROs to commit to detailed undertakings that typically include a commitment to expend large sums for corrective action. For example, in 1996 the NASD agreed to spend up to $100 million over five years, in 1997 the Philadelphia Stock Exchange agreed to spend $5 million over three years, and in 2000, the Options Exchanges agreed to spend $77 million over two years. More recently, the SEC has begun a trend of imposing significant monetary sanctions on SROs.

When the SEC believed that corporate governance problems existed, settlement terms have focused on the membership and functioning of the SRO board and corporate governance issues. For example, as part of the BSE settlement, the BSE agreed to form a Special Management Review Committee to review and report its findings regarding procedures for nominating members of the BSE Board, the Board of Governors' oversight of BSE management to determine whether the BSE was fully discharging its SRO responsibilities, deficiencies in the nomination and oversight functions, and the process by which the three members of the Board of Governors who had been sanctioned in the exchange's disciplinary action were subsequently renominated and reelected to the BSE Board.

Similarly, when it has appeared that an SRO's disciplinary process was flawed, the SEC has required changes. For example, in settling the first CBOE proceeding described above, the CBOE agreed to changes in its disciplinary process that included prohibiting *ex parte* contacts between members of the BCC and any CBOE member or associated person concerning any pending disciplinary matter, and eliminating the authority of the Chairman of the CBOE Executive Committee to appoint to CBOE committees exchange members who appeared likely to become party to an exchange proceeding. The settlement also required that the CBOE Board be allowed to review BCC decisions that disciplinary charges should not be initiated. In the more recent CBOE proceeding, the CBOE agreed to a top-to-bottom review of its regulatory program for the purpose uncovering and eliminating any concerns.

## III. SUMMARY OF RELEVANT DELAWARE CORPORATE LAW

### Statutory Provisions

Because they are organized in Delaware, the General Corporation Law of the State of Delaware ("General Corporation Law") is applicable to Nasdaq and its primary SEC-regulated U.S. subsidiaries.

### The Business Judgment Rule

The business judgment rule is the fundamental precept of director conduct that forms the principal defense in any litigation that seeks to challenge the prudence or wisdom of director action. The rule presumes that, in making a business decision, corporate directors acted on an informed basis, in good faith, and in the honest belief that the action taken was in the corporation's best interests. Under the rule, a court will not substitute its judgment for that of the board if the latter's decision can be attributed to any rational business purpose. Whether the decision is the best decision, or even a reasonable decision, is beyond the scope of the court's consideration.

For the business judgment rule to apply, directors must satisfy the duties of care and loyalty. The basic standards of conduct applicable to directors flow from judicial interpretations of these duties.

The protections of the business judgment rule are unavailable if, among other circumstances, a board has abdicated its functions or has failed to act in the face of a known duty to act. When the business judgment rule is unavailable, the board will bear the burden of demonstrating that its decision was entirely fair to stockholders.

**The Duty of Care**

The duty of care requires that a director be reasonably informed, exercise independent judgment and participate in decisions in good faith and with the care of an ordinarily prudent person in similar circumstances. The elements of the duty of care generally include:

- Informed and independent judgment -- a director should regularly attend board meetings. Each director, no matter how selected, shares all of the responsibilities and powers of the directors. Even if a director is viewed as representing a particular group or interest, the director's duties are to the entire organization, and are identical to those of other directors. A director must have adequate sources of information. In general, directors may rely on information provided by corporation staff. If, however, the director believes that staff-supplied information is inadequate in any respect, the director should request further information.

- Reliance -- directors may, in the ordinary course of business, act in reliance on information and reports received from regular sources the director reasonably regards as trustworthy. A director may rely on the information received from another director, a committee, or corporate officers, employees, or agents the director reasonably believes to be reliable and competent. However, a director may not rely on such information if he or she has knowledge about a matter that would make such reliance unreasonable.

- Delegation -- the board of directors does not operate the day-to-day business of the corporation. In delegating that function to others, the board sets policies and oversees the corporate agents. Although the board as a whole may delegate functions to others (for example, staff or board committees), individual directors may not delegate to others their responsibilities as directors, and may not vote by proxy.

Much of the Delaware law on the duty of care has been developed in change-of-control cases. In the majority of cases in which the issue has been raised, corporate directors have been found to have satisfied their duty of care. However, Delaware case law does underscore that time for reflection and adequate information are cornerstones of the duty of care. For example, there have been cases in which directors were held liable for approving a merger during a relatively short board meeting, without advice from an investment bank, without adequate understanding of the terms of the agreement or whether the sale price reflected the full value of the corporation. In another case, directors were found to have breached their duty of care in approving a merger when most of the directors had little or no knowledge of the transaction before the board meeting, and the board did not take reasonable steps to be adequately informed before it acted.

The Directors should ensure that they take time, consider information provided to them or brought to their attention and, when good business judgment warrants, should request further information. The Board should take reasonable steps to ensure that management is competent, informed, and acting appropriately on information it receives. Directors will likely meet their duty of care if they behave as a reasonable person could be expected to behave, remain involved and informed, and act when warranted.

As discussed above, the status of certain of Nasdaq's subsidiaries as SROs imposes upon Nasdaq regulatory obligations that do not apply to other types of corporations. These regulatory obligations significantly affect the scope of the duty of care required by the Directors. In particular, these duties relate to broker-dealers' compliance with the Exchange Act, the Exchange Act Rules, and the rules of the SRO subsidiaries. The Boards of SROs must ensure that adequate policies and procedures are in place to ensure that members comply with applicable rules, and that appropriate action is taken in the event of noncompliance. Nasdaq Directors should be aware of these obligations and ensure that the SRO subsidiaries also act in a manner consistent with these obligations. The interplay between these regulatory obligations and Delaware fiduciary duties is discussed in more detail below.

**The Duty of Loyalty**

Generally, directors owe a duty of loyalty to the corporation and its stockholders. The duty of loyalty requires that directors act in the best interests of the corporation and refrain from actions that would harm the corporation and its stockholders or deprive them of an advantage.

A key component of the duty of loyalty is the disinterestedness and independence of the director. When a director is interested or is not independent -- that is, when conflicts actually exist between the personal interest of the director and the interest of the corporation or when the director is controlled by or beholden to another person or entity with such an interest -- the director's loyalty is called into question and measures must be taken to ensure that the conflict is fully disclosed and the decision made is in the best interests of the corporation.

The duty of loyalty also includes a director's obligation to act in good faith. The Delaware Supreme Court has noted that a director fails to act in good faith, among other things, where that director (i) intentionally acts with a purpose other than that of advancing the best interests of the corporation, (ii) acts with the intent to violate applicable positive law, or (iii) intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for the director's duties.

Directors of Nasdaq must act at all times in the best interests of Nasdaq and its stockholders and not compromise those interests due to personal considerations. The Directors cannot act to benefit their personal interest or to protect themselves at the expense of Nasdaq or its stockholders. The Directors should also act honestly and in a manner that is not knowingly unlawful or contrary to public policy.

**Regulatory Obligations and Fiduciary Duties**

It is important to note that the regulatory obligations of the Directors of Nasdaq are complementary to, and not in conflict with, the fiduciary obligations of the Directors. In considering what is in the best interests of the corporation and its stockholders, a Director can consider many issues besides short-term maximization of stockholder value. These issues include many factors, such as long term growth, strategic investments, enhanced reputation and legal compliance that might not maximize stockholder value, at least in the short term. Unless the corporation has put itself up for sale, "a board of directors, while always required to act in an informed manner, is not under any per se duty to maximize shareholder value in the short term…." *Paramount Communications v. Time, Inc.*, 571 A.2d 1140, 1150, 1154 (Del. 1989) ("Directors are not obligated to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.").

As a result, the Board has discretion, after informed deliberation, to take an action that may cost money in the short-term, but serves a longer-term goal. For example, the Board's decisions to fund and operate market surveillance systems would be shielded by the presumptions of the business judgment rule even though such systems do not generate revenue for stockholders. The case law described above suggests that Delaware law would recognize that such systems are integral to maintaining the integrity of markets operated by Nasdaq, which is crucial to the long-term economic interests of Nasdaq and to the maintenance of needed regulatory approvals.

Delaware law also requires that directors comply with applicable law. The General Corporation Law allows corporations to engage only in lawful business. Section 102(b)(7) of the General Corporation Law prohibits corporations from shielding directors from liability for "intentional misconduct and knowing violations of law." As a result, Delaware law requires that the Board comply with any law applicable to Nasdaq and its subsidiaries.

In fact, directors of Delaware corporations risk breaching their fiduciary duties if they do not take steps to ensure that the corporation complies with state and federal law. In *Caremark International Inc.*, 698 A.2d 959 (Del. Ch. 1996), the Delaware court indicated that directors could breach their fiduciary duties by failing to implement an information and reporting system reasonably designed to detect violations of state and federal law. The Delaware courts have further held that, if such a system has been implemented, the directors could breach their fiduciary duties by failing to act to promote compliance with law in response to red flags putting the directors on notice of wrongdoing by the corporation. The *Caremark* decision and its progeny show that Delaware law incentivizes directors and management to comply with state and federal law and to design monitoring systems to ensure that their subordinates also comply with applicable law.

**Provisions of Nasdaq Corporate Documents**

The importance of regulatory obligations is highlighted in Nasdaq's Certificate of Incorporation and By-Laws. Article Eleventh of the Certificate of Incorporation of Nasdaq reads in part:

> the Board of Directors, when evaluating … any … issue, shall… take into account all factors that the Board of Directors deems relevant, including, … the potential impact thereof on the integrity, continuity and stability of Nasdaq, and The NASDAQ Stock Market LLC and the other operations of Nasdaq and its subsidiaries, on the ability to prevent fraudulent and manipulative acts and practices and on investors and the public….

The By-Laws of Nasdaq provide that the Directors of Nasdaq

> shall give due regard to the preservation of the independence of the self-regulatory function of each … Self-Regulatory Subsidiary and to its obligations to investors and the general public and shall not take any actions which would interfere with the effectuation of any decisions by the Board of Directors of any Self-Regulatory Subsidiary relating to its regulatory functions (including disciplinary matters) or the market structures or clearing systems which it regulates or which would interfere with the ability of any Self-Regulatory Subsidiary to carry out its responsibilities under the [Exchange] Act.

The Nasdaq By-Laws also provide that the Directors of Nasdaq will be deemed Directors of each SRO subsidiary for purposes of SEC oversight pursuant to the Exchange Act, and are obligated to cooperate with the SEC in respect of its oversight responsibilities.

In addition, Nasdaq's corporate documents contain provisions that in most respects provide Directors with all of the protections allowable under Delaware law. These include provisions in the Certificate of Incorporation of Nasdaq that are allowed by Delaware Law and that relieve Directors from liability for monetary damages to Nasdaq or its stockholders to the extent that such relief is not specifically prohibited by Delaware law. The general effect of these provisions is to afford relief from monetary damages for breach of the duty of care. The General Corporation Law prohibits such relief for breaches of the duty of loyalty, for acts or omissions not taken in good faith or involving intentional misconduct (including where the director had reasonable cause to believe the actions were illegal), for unlawful dividends, stock repurchases or redemptions and for transactions in which a Director derives an improper personal benefit.

The By-Laws of Nasdaq provide that Directors shall be indemnified against judgments, fines, amounts paid in settlement and expenses (including attorneys' fees and other costs), and that costs shall be advanced in each case to the fullest extent permitted by Delaware Law. In addition, Nasdaq has procured insurance policies providing coverage for directors' and officers' liability. These policies protect Board members from liability arising from lawsuits brought against Nasdaq and its Board.

## IV. SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") increased corporate governance duties and oversight responsibilities of corporate Boards of public companies, including Nasdaq, and their committees. Some of the key areas of concern for Board members are:

- SEC Reporting. Sarbanes-Oxley gives the Board, and more particularly the Audit Committee, increased responsibility for overseeing the accuracy of Nasdaq's financial statements, disclosure controls and procedures, and internal controls. The responsibility of Board members includes assessing the reasonableness of management's accounting judgments and estimates and reviewing key regulatory filings. The Audit Committee is directly responsible for the appointment, compensation, and oversight of an issuer's public auditor and must also determine whether engaging independent counsel and other advisors is necessary.

- Whistle-blower procedures. The Board is responsible for overseeing the implementation of effective whistle-blower procedures. In particular, the Audit Committee must establish procedures that facilitate the reporting of illegal activity to the proper persons and protect whistle-blowers from retaliation.

- Executive and Director Loans. Sarbanes-Oxley prohibits personal loans or extensions of credit to executive officers and directors. Accordingly, the Board must carefully review certain compensation arrangements and make informed decisions regarding their legality.

- Attorney Communications. Under Sarbanes-Oxley, attorneys may be required to report "up the ladder" to the Audit Committee and Board level credible evidence of a material violation of the securities law or breach of fiduciary duty or similar violation of the company or an agent of the company. The Board must ensure that proper procedures are in place to facilitate these communications and respond accordingly.

These are just some of the comprehensive reforms mandated by Sarbanes-Oxley. The SEC may consider additional rules that could further increase the duties of Board members. Non-compliance with Sarbanes-Oxley could result in serious criminal and civil penalties for Board members and Nasdaq. The Office of General Counsel, the Corporate Secretary, the Audit Committee and others will advise Board members throughout their tenure on compliance with Sarbanes-Oxley.

## V. LISTING STANDARDS

In February 2005, Nasdaq listed on The NASDAQ National Market and formally became subject to the Nasdaq Exchange's listing standards. These standards are set forth in the Nasdaq Exchange Listing Rules. Set forth below are summaries of certain rules applicable to directors of a Nasdaq-listed company.

- Independent Directors. Nasdaq Exchange listing rules generally require that a majority of a listed company's Board be comprised of independent directors. In addition, the audit and compensation committees must be comprised entirely of independent directors, and independent directors must be involved in decisions regarding the nomination of directors.

For a director to be considered independent, the board must determine that the director has no relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The Nasdaq Exchange rules specify certain relationships that would preclude independence, including employment with the company; the receipt of more than $120,000 in payments other than for board services; and payments between Nasdaq and certain entities with which a director is affiliated, if those payments exceed the greater of $200,000 or 5% of the recipient's revenues. If a family member of the director has certain of these relationships, the director may also be precluded from being considered independent. Nasdaq relies on the director's questionnaire to identify the relevant relationships, but Board members should also contact the Office of General Counsel or the Corporate Secretary in the event a new relationship develops.

- <u>Conflicts of Interest.</u> Nasdaq Exchange listing rules requires that the audit committee or another independent body of the Board conduct appropriate review and oversight of related party transactions. Nasdaq satisfies this requirement by obtaining audit committee approval of related party transactions. (The Nasdaq audit committee has pre-approved limited classes of transactions and in some cases may approve transactions after the fact.) Item 404(b) of SEC Regulation S-K requires companies to disclose their policies and procedures for the review, approval, or ratification of related party transactions.

- <u>Code of Conduct.</u> The listing rules require that Nasdaq have a code of conduct applicable to all directors, as well as officers and employees. Any waivers of the code for directors and executive officers must be approved by the Board and publicly disclosed on a Form 8-K.

- <u>Shareholder Approval.</u> Nasdaq Exchange listing rules may require shareholder approval for an issuance of common stock or a security convertible into common stock to a director or an entity affiliated with a director, if that issuance is at a price less than the market value of the stock.