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 Nasdaq'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, as amended (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 reasonable justification or excuse has failed to enforce compliance with any of the Governing

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

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.

In addition, Nasdaq is the controller of exchanges and other regulated entities in various international jurisdictions. Accordingly, the Board has an obligation to ensure that the structure and resources of Nasdaq's overall organization 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. 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 when warranted, or members of the SRO's disciplinary decisional body were tainted or otherwise subject to improper influences.

Sanctions imposed in these 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. 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. Similarly, when it has appeared that an SRO's disciplinary process was flawed, the SEC has required changes to that process.

III. SUMMARY OF RELEVANT DELAWARE CORPORATE LAW

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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.

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 as to both process and price.

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, corporate officers and employees, or advisors and experts selected with reasonable care that the director reasonably believes to be reliable and competent. However, a director may only rely in good faith and 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 certain 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 Delaware law on the duty of care has been developed in change-of-control cases. In many of the 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, and 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.

Directors should ensure that they take time and avoid acting in haste, consider information provided to them or brought to their attention and, when good business judgment warrants, 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 rules and regulations promulgated under the Exchange Act, and the rules of the SRO subsidiaries. The Boards of SROs should endeavor to ensure that adequate policies and procedures are in place in an effort 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 endeavor to 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 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. Directors cannot act to benefit their personal interest or to protect themselves at the expense of Nasdaq or its stockholders. 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 *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996), the Delaware Court of Chancery 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 or a knowing violation of law, 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 & Risk 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 & Risk Committee is directly responsible for the appointment, compensation, and oversight of Nasdaq'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 & Risk 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 & Risk Committee and Board level credible evidence of a material violation of the securities laws or breach of fiduciary duty or similar violation by Nasdaq or an agent of Nasdaq. 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. 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 & Risk 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 Listing 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 the company 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.

- Conflicts of Interest. Nasdaq Exchange Listing Rules require that the Audit & Risk Committee or another independent body of the Board conduct appropriate review and oversight of related party transactions. Nasdaq satisfies this requirement by obtaining Audit & Risk Committee approval of related party transactions. (The Nasdaq Audit & Risk 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.

- Code of Conduct. The Nasdaq Exchange 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.

- Stockholder Approval. Nasdaq Exchange Listing Rules may require stockholder 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.