

Seat to conduct business on the Exchange. Governance Members and Member Organizations may also purchase an Exchange Seat in order to lease it to third persons with the expectation of lease income and appreciation in the value of the Exchange Seat itself. However, as a result of their governance positions on the Board or on an Exchange Committee, Governance Members may learn Material Confidential Information regarding the Exchange that may affect the value of all Exchange Seats, or the value of particular Exchange Seats. As defined in the Seat Transaction Policy, Material Confidential Information is confidential and proprietary to the Exchange and may not, under the Governance Members Code of Conduct, Exchange policy, and applicable law, be disclosed or used for personal gain.

On the other hand, the Exchange notes that failure to disclose Material Confidential Information to a potential purchaser or seller of an Exchange Seat could expose the Governance Member and/or Member Organization to liability to the potential purchaser or seller under state law. Any time a Governance Member purchases or sells an Exchange Seat while the Governance Member possesses such Material Confidential Information, the Exchange states that the Governance Member and (as a consequence of information sharing by such Governance Member with other persons at his/her associated Member Organization) Member Organization could be exposed to disciplinary action, liability, and disrepute. The Exchange states that such conduct by the Governance Member or Member Organization could also expose the Exchange to disrepute.

Therefore, the Exchange adopted the Seat Transaction Policy in order to resolve the tension between a Governance Member's and/or Member Organization's legitimate business needs to purchase or sell Exchange Seats from time to time and the Exchange's legitimate business interest in preventing disclosure of Material Confidential Information to anyone involved in a Seat Transaction.

The Exchange notes that in many cases, disclosure of Material Confidential Information to the other purchaser or seller in the Seat Transaction would put the Governance Member or Member Organization and the buyer or seller on equal footing in order to negotiate a fair price for the Seat—and could in some cases be legally required in order to avoid liability to the party with whom the Governance Member or Member Organization is dealing. However,

Governance Members are required by the Governance Members Code of Conduct to keep Material Confidential Information confidential. The Exchange states that the Seat Transaction Policy is designed to accommodate both of these interests by allowing a Special Committee to review the facts surrounding a seat transaction and, if necessary, to impose conditions on the seat transaction in order to prevent or limit disclosure of Material Confidential Information of the Exchange to third parties.

Seat Transaction Policy

In Articles V.1 and V.2 of the proposed Seat Transaction Policy, the Exchange proposes to create a new Special Committee (the "Special Committee") of the Board of Governors that would oversee Seat Transactions by Governance Members and Member Organizations.¹⁰ Article V.3 would provide that the Special Committee, which is to be composed of three members, all of whom are Governors and at least one of whom is a Public Governor, would be responsible for examining the facts of each proposed Seat Transaction by a Governance Member or Member Organization.¹¹ Article V.4 of the Seat Transaction Policy empowers the Special Committee to prohibit any Governance Member or Member Organization from entering into a Seat Transaction while they possess Material Confidential Information of the Exchange.

Article V.3 of the Seat Transaction Policy further provides that the Special

¹⁰ If the entire Special Committee cannot be convened, the Special Committee may proceed with a quorum of its members or may proceed with substituted members appointed by the Board of Governors or the Board's Executive Committee. By-law Article X, section 10-3(a) sets the quorum of the Special Committee as the majority of its members then in office. A quorum of the Special Committee, therefore, is two members. In addition to the quorum requirements in By-law Article X, section 10-3(a), the Board directs that at least one of the members making a quorum be a Public Governor. The Special Committee could take action, pursuant to By-law Article X, section 10-3(a), if a majority of those voting at a meeting at which a quorum is present vote in favor of the motion at hand, provided at least two vote. The Board of Governors or the Board's Executive Committee could appoint substituted members to the Special Committee, as needed. By-law Article IV, Section 4-4(b)(ix) empowers the Board to designate and appoint special committees, such as the one at hand. The Board may appoint additional Governors to the Special Committee to fill-in for absent Governors. In addition, the Board's Executive Committee, by resolution of the Board passed on December 11, 2002, may appoint Governors to the Special Committee to fill-in for absent Governors.

¹¹ The members of the Special Committee are subject to the conflict avoidance and recusal provisions that are in By-law Article IV, Section 4-8 and in the Governance Member Code of Conduct, Article III.6.

Committee may impose certain specified restrictions upon a Seat Transaction to prevent potential misuse or disclosure of Material Confidential Information by the Governance Member or Member Organization,¹² or by the person or firm on the other side of the Seat Transaction. As proposed, the Special Committee would determine whether it is appropriate for such Material Confidential Information to be disclosed by the Governance Member or Member Organization in connection with a proposed Seat Transaction. The Special Committee would also require that a confidentiality agreement be established between the Governance Member or Member Organization and the person on the other side of the Seat Transaction. If such a confidentiality agreement is required, the Seat Transaction Policy would require that the Exchange be named as an intended third-party beneficiary of the agreement.

Proposed Article V.4 provides that, the Special Committee may prohibit any Governance Member or Member Organization from consummating a Seat Transaction under conditions contrary to the conditions set forth by the Special Committee, or during certain "window periods"¹³ specified by the Special Committee.

Governance Member Responsibilities

Proposed Article V.3(a) requires that at the time a Seat Transaction is contemplated, the Governance Member or Member Organization notify the Board of Governors by notifying certain Exchange officers.¹⁴ Article V.3(a) further requires that the Special Committee convene promptly after such

¹² The Exchange states that the Seat Transaction Policy recognizes that it may not in all instances be appropriate to attribute Material Confidential Information possessed by a Governance Member to the entire Member Organization for which he/she serves as an officer or director. Consistent with the policies of the federal securities laws (see, e.g., Rule 14e-3 under the Act, 17 CFR 240.14e-3, and Phlx Rule 1020(f)), the Policy authorizes the Special Committee to review any information barriers that a Member Organization may have established to restrict the flow of Material Confidential Information within its organization and to take the existence of such information barriers into account when reviewing a proposed Seat Transaction.

¹³ An example of a "window period" during which Seat Transactions may be prohibited is prior to the announcement of a significant transaction involving the Exchange.

¹⁴ Except to the extent that the Special Committee excuses a Governance Member or Member Organization as provided in the next sentence, this is mandatory in respect of all Seat Transactions by Governance Members and their Member Organizations. However, the Special Committee could excuse the Governance Member or Member Organization from this disclosure requirement if the Special Committee determines that all or certain future disclosures are rendered unnecessary by the implementation and operation of the information barriers described in footnote 12, above.