

will evaluate the Plan and determine whether the company has made reasonable demonstration in the Plan of an ability to regain compliance with the continued listing standards within the three month period. The Committee will make such determination within 45 days of receipt of the proposed Plan, and will promptly notify the company of its determination in writing. If the Committee does not accept the Plan, the Exchange will promptly initiate delisting proceedings as provided in subsections (a)–(g) below. If Exchange staff accepts the Plan, the three month Plan period will commence on the date the issuer is notified of such acceptance. The Exchange will then review the company on a periodic basis for compliance with the Plan. If the company does not show progress consistent with the Plan, the Committee will review the circumstances and variance, and determine whether such variance warrants the commencement of delisting procedures. Should the Committee determine to proceed with delisting procedures, it may do so regardless of the company's continued listing status at that time. If, prior to the end of the three month Plan period, the company is able to demonstrate compliance with the continued listing standards at the end of the three month Plan period, the Exchange will deem the Plan period over. If the company does not meet continued listing standards at the end of the three month Plan period, the Exchange will promptly initiate delisting procedures. If the company, within twelve months of the end of the Plan (including any early termination of the Plan period) is again determined to be below continued listing standards, the Committee will examine the relationship between the two incidents of falling below continued listing standards and re-evaluate the company's method of recovery from the first incident. It will then take appropriate action which, depending upon the circumstances, may include truncating the procedures described above or immediately initiating delisting procedures.

Whenever the Exchange determines that it is appropriate to consider removing a security from listing [(or from unlisted trading)] for other than routine reasons (redemptions or maturities) it will follow the following procedures:

(a)–(g) No change.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Phlx included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Phlx has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to amend Phlx Rule 849 to provide enhanced listing standards related to Phlx-listed issuers' audit committees, and to amend Phlx Rule 811 to incorporate a procedure to provide issuers a "cure period" prior to being delisted for failure to meet Exchange listing standards. The changes are summarized below.

Rule 849, Audit Committee/Conflicts of Interest.

Independence—Background. Currently, Phlx Rule 849 requires listed companies to maintain audit committees, a majority of the members of which are "independent directors" as defined in Phlx Rule 851. Phlx Rule 851 requires listed issuers to maintain a minimum of two independent directors on its board and defines "independent director" as 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 board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. This current requirement would remain in effect pending the implementation of the higher standards proposed in Phlx Rules 849(b)–(j). Proposed Phlx Rule 849(b) would require a listed issuer to have, and to certify that it has and will continue to have, an audit committee, as defined in Section 3(a)(58) of the Act, of at least three members, each of whom meet certain criteria set forth in proposed Phlx Rule 849(b).

Independence—Blue Ribbon Committee Recommendations. Proposed Phlx Rule 849(b)(1)(i) would require each member of the audit committee to be a member of the board of directors of the listed issuer and to be otherwise

independent.⁶ Proposed Rules 849(b)(1)(i)(A) through (D) are based in large part upon Rule 5.3(b)(3)(i)–(iv) of PCX Equities, Inc.,⁷ and would preclude employees and those with business relationships from serving on a listed company's audit committee. They would also prohibit audit committee service by a director who is employed as an executive of another corporation where any of the company's executives serves on that corporation's compensation committee. Further, a director who is an "Immediate Family" member of an individual who is an executive officer of the company or any of its affiliates cannot serve on the audit committee until three years following the termination of such employment relationship.

Independence—Rule 10A–3

Requirements. Proposed Phlx Rules 849(b)(1)(ii) and (iii) prescribe certain independence requirements for audit committee members of non-investment company issuers and for investment company issuers, respectively, which are mandated by Commission Rule 10A–3(b)(1)(ii) and (iii). Proposed Phlx Rules 849(b)(1)(iv)(A) through (F) provide a number of exemptions from the Phlx Rule 849(b)(1) independence requirements as permitted by Commission Rule 10A–3(b)(1)(iv).⁸

Responsibilities Relating to Registered Public Accounting Firms, Complaints, Authority to Engage Advisers and Funding. Phlx Rules 849(b)(2)–(5) provide for the audit committee's responsibility to select and oversee the issuer's independent accountant, procedures for handling complaints regarding the issuer's accounting practices, the authority of the audit committee to engage advisors, and funding for the independent auditor and any outside advisors engaged by the

⁶ However, where a listed issuer is one of two dual holding companies, those companies may designate one audit committee for both companies so long as each member of the audit committee is a member of the board of directors of at least one of such dual holding companies.

⁷ PCX Equities, Inc. Rules 5.3(b)(3)(i)–(iv) were approved by the Commission on February 7, 2001. See Securities Exchange Act Release No. 43941 (February 7, 2001), 66 FR 10545 (February 15, 2001) (approving SR-PCX-00-40). The rules had been proposed to conform to recommendations made in 1999 by the Blue Ribbon Committee on Improving Effectiveness of Corporate Audit Committees (the "Blue Ribbon Committee") and rule changes adopted by other self-regulatory organizations. The Blue Ribbon Committee's recommendations were intended to strengthen the independence of the audit committee, make the audit committee more effective, and address mechanisms for accountability among the audit committee, the outside auditors, and management.

⁸ The Commission notes that Phlx did not include the exception provided for in Commission Rule 10A–3(b)(1)(iv)(A)(1).