

(including audit committees, nominating committees and compensation committees), which are set forth in CHX Article XXVIII, Rules 19 and 21 (collectively, the "CHX Governance Standards"). The proposed amendments to the CHX Governance Standards constitute a comprehensive group of significant changes to the Exchange's listing standards and are intended to enhance investor confidence by helping to ensure the independence of corporate directors and strengthening corporate governance practices. The Exchange believes that the additional proposed changes to the Exchange's maintenance listing standards, which are found in CHX Article XXVIII, Rules 17A and 22, will ensure continued compliance with the CHX Governance Standards, while also providing issuers an opportunity to cure failures to meet those (and other) on-going requirements.⁴

These changes to the CHX Governance Standards and to the CHX's maintenance listing standards are designed to comply with the provisions of Section 10A(m) under the Act⁵ and SEC Rule 10A-3 thereunder;⁶ they also include additional enhancements to the Exchange's governance requirements for listed companies.⁷ In most respects, the Exchange believes that proposed changes are substantially similar to governance changes proposed by the National Association of Securities Dealers, Inc. and the American Stock Exchange LLC.⁸ The Exchange also states that a few of the proposed changes—particularly those made to the CHX maintenance standards or incorporated within at least one new definition—mirror existing rules or proposals of the New York Stock Exchange, Inc. ("NYSE").⁹

⁴ A few additional clerical changes are also made; these changes re-number the paragraphs within affected rules and add new headings for certain paragraphs.

⁵ 15 U.S.C. 78j-1(m).

⁶ 17 CFR 10A-3. The Commission notes that the CHX intends to amend the proposed rule change to fully conform with SEC Rule 10A-3. Telephone conversation between Kathleen M. Boege, Vice-President and Associate General Counsel, CHX, and Ira L. Brandriss, Special Counsel, Division, Commission, on October 10, 2003.

⁷ The Commission notes that the CHX will consider amendments to the proposed rule change once the Commission approves proposals on corporate governance matters filed by other exchanges. Telephone conversation between Kathleen M. Boege, Vice-President and Associate General Counsel, CHX, and Ira L. Brandriss, Special Counsel, Division, Commission, on October 10, 2003.

⁸ See Securities Exchange Act Release No. 47516 (March 17, 2003), 68 FR 14451 (March 25, 2003) (SR-NASD-2002-141) and SR-Amex-2003-65.

⁹ See Securities Exchange Act Release No. 47672 (April 11, 2003), 68 FR 19051 (April 17, 2003) (SR-

The CHX Governance Standards will apply to all companies listing common stock on the Exchange, with particular exemptions for controlled companies, limited partnerships, companies in bankruptcy, closed-end management companies and foreign issuers. Under proposed Article XXVIII, Rule 19, Interpretation and Policy .03, passive business organizations (such as royalty trusts) will not be subject to these standards, nor will the standards apply to derivatives or special purpose securities, if those entities and securities are exempt from the requirements of Rule 10A-3 under the Act.¹⁰ Under proposed Article XXVIII, Rule 19, Interpretation and Policy .04, additional exemptions will exist for dual and multiple listings, where the same or another class of security of the company is already listed on another national securities exchange or national securities association that has similar governance-related requirements. The proposed CHX Governance Standards will apply to companies that list securities under Tier I or Tier II of the CHX's listing standards.

Summarized below are the principal categories of change to the CHX Governance Standards.

Definition of "Independence"

The Exchange believes that it is critical for investors to have confidence that an individual serving as an independent director does not have any relationship with the issuer (or its officers) that would impair the director's independence. Accordingly, in addition to the existing CHX rule language, which generally precludes any relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director, the proposed amendments specifically identify six categories of persons who shall not be considered independent under proposed CHX Article XXVIII, Rule 19(o)(3).

In general, persons who shall not be considered independent include: (i) A director employed by the issuer or its parent or subsidiary during the previous three years; (ii) a director who accepts (or who has immediate family members who accept) any payments from the issuer in excess of \$60,000 during the current year or any of the past three fiscal years (other than compensation for board service, payments from investments in the issuer's securities, compensation to non-executive family members, tax-qualified retirement

benefits or non-discretionary compensation); (iii) a director who is an immediate family member of an individual who is, or who served during the previous three years, as an executive officer of the issuer or its parent or subsidiary; (iv) a director who is a principal (*i.e.*, a partner, controlling shareholder or executive officer) in any organization that received payments from the issuer, or that made payments to the issuer, exceeding 5% of the recipient's consolidated gross revenues for the year or \$200,000, whichever is greater; (v) a director who is an executive officer of another entity, if there is compensation committee overlap between the issuer and such entity currently or during the past three years; and (vi) a director who was a partner or employee of the issuer's outside auditor, and worked on the issuer's audit, during any of the past three years.

Under proposed CHX Article XXVIII, Rule 19(o)(2), the proposed amendments define an immediate family member as a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law and any person who has the same residence as the director in question.

Independent Board and Board Committees

Through the exercise of independent judgment, independent directors act on behalf of investors to maximize shareholder value and guard against conflicts of interest. Accordingly, under proposed Article XXVIII, Rule 19(a), the proposed amendments require most issuers to maintain a majority of independent directors on their boards; small business issuers will be required to have boards consisting of at least 50% independent directors. The proposed rule also requires regularly convened executive sessions of the independent directors. The Exchange states that regularly scheduled executive sessions will encourage and enhance communication among independent directors. A controlled company would be exempt from this requirement.¹¹

Under proposed CHX Article XXVIII, Rule 19(c), the nomination of the issuer's directors will be determined by independent directors. Independent director oversight of the director nomination process should enhance investor confidence in the selection of well-qualified director nominees. This

¹¹ Under the definition in proposed in CHX Article XXVIII, Rule 19(o)(1), a "controlled company" would mean a company of which more than 50% of the voting power is held by an individual, group or other company.

NYSE-2002-33) and NYSE Listed Company Manual Section 802.

¹⁰ 17 CFR 240.10A-3.