

rule would not apply in cases where the right to nominate a director legally belongs to a third party.<sup>12</sup>

The proposal under proposed CHX Article XXVIII, Rule 19(d) also contemplates independent director approval of the compensation of an issuer's officers.<sup>13</sup> The Exchange believes this oversight will help ensure that appropriate executive incentives are in place, consistent with the board's responsibility to maximize shareholder value.

#### Audit Committee Requirements

Under proposed CHX Article XXVIII, Rule 19(b), the proposed amendments would expand existing CHX requirements relating to audit committee composition and would include new requirements relating to that committee's role and authority. With very limited exceptions set forth in the proposed rule, each member of an issuer's audit committee: (i) Must be an independent director; (ii) must meet the criteria for independence set forth in SEC Rule 10A-3; and (iii) must be able to read and understand fundamental financial statements, including a company's balance sheet, income statement and cash flow statement.<sup>14</sup>

The proposed amendment would require each issuer's audit committee to have the responsibilities and authority set out in SEC Rule 10A-3 (and to act in accordance with those provisions) and to have a written charter to specify the audit committee's minimum purposes, duties and responsibilities, including those that are required by the SEC Rule and by the Sarbanes-Oxley Act.<sup>15</sup> The written charter must be reviewed, and its adequacy must be reassessed on an annual basis by the audit committee.

#### Code of Business Conduct and Ethics

Under the proposed rules, each issuer would be required to adopt a code of

conduct and ethics that applies to its directors, officers and employees and that meets the requirements of section 406(c) of the Sarbanes-Oxley Act. Under proposed CHX Article XXVIII, Rule 19(e), waivers of the code for directors and officers would need to be approved by the issuer's board of directors and be made publicly available.

#### Governance-Related Certifications

Given the importance of the requirements set forth in the CHX Governance Standards, the proposed amendments contain a requirement that each issuer's chief executive officer certify, on an annual basis, that he or she is not aware of any violation by the issuer of any standard set forth in CHX Article XXVIII, Rules 19(a)–(e). Further, under proposed CHX Article XXVIII, Rule 19(f), such chief executive officer is required to promptly notify the Exchange if any executive officer of the issuer becomes aware of any material non-compliance by the issuer with those standards.

#### Changes to CHX Maintenance Standards

For both Tier I and Tier II issuers under proposed CHX Article XVIII, Rules 17A and 22, the proposed amendments contemplate a process whereby the Exchange would provide non-compliant issuers with notice and an opportunity to cure the stated deficiency. These provisions would apply to situations in which an issuer fails to meet governance-related standards, as well as those in which an issuer fails to meet other maintenance standards.

In general, the proposed rule amendments would require the Exchange to notify a non-compliant issuer in writing of the Exchange's determination and the reasons for such determination. The issuer would then be required to respond within 10 business days to confirm its receipt of the letter and to advise the Exchange whether or not the issuer intends to submit a plan for curing the deficiency. Any plan must describe definitive action that the issuer has taken or is taking that would bring it into conformity with the Exchange's standards within 18 months, or within any shorter period of time required by the Exchange.<sup>16</sup> The plan must be submitted within 45 days after receiving

the Exchange's determination of deficiency. If the Exchange accepts the plan, the Exchange would assess the issuer's progress on a quarterly basis. If the Exchange does not accept the plan, the Exchange would initiate proceedings to suspend and/or delist the issue. While the plan is in effect, the Exchange could initiate proceedings to suspend and/or delist the issue if the issuer fails to meet a material provision of the plan or fails to meet quarterly milestones.

The foregoing procedures would not preclude the Exchange from taking immediate action to suspend trading in an issue, if such action is necessary for the protection of investors.

#### Application of Standards to Issuers With Dual or Multiple Listings

Because the majority of the Exchange's issuers have securities that are also listed on one or more other markets, the Exchange has included a provision in its proposed rule amendments under proposed CHX Article XVIII, Rule 19, Interpretation and Policy .04 that would exempt such issuers from the CHX Governance Standards if the issuer is listed on a national securities exchange or national securities association with listing standards substantially similar to the CHX Corporate Governance Standards. The proposed rule text contains specific criteria that must be considered when determining whether another market's governance standards are "substantially similar."

#### Schedule for Effectiveness of Proposed Rule Changes

The CHX anticipates that the proposed rule changes to CHX Governance Standards will become effective in accordance with the timetable set forth in proposed CHX Article XXVIII, Rule 19, Interpretation and Policy .05. In general, following Commission approval of the proposed rule changes: (i) The audit committee requirements mandated by Rule 10A-3 under the Act (and the exception set out in CHX Article XXVIII, Rule 19(b)(1)(B)(ii)) will become effective as set out in Rule 10A-3 for all issuers; (ii) the other CHX Governance Standards will become effective two years after they are approved by the Commission, with a one-year "grace period" for issuers with staggered term boards; and (iii) issuers listing on the Exchange in connection with an initial public offering or transferring from another marketplace with different governance standards will be required to comply with CHX Governance Standards within

<sup>12</sup> The rule incorporates other limited exceptions that would permit certain persons to serve on the nominating committee, if the issuer's board determines that a person's membership on the committee is required by the best interests of the company and its shareholders and the board discloses the nature of the relationship and the basis for its determination in the next annual meeting proxy statement following that determination. An issuer's chief executive officer would be permitted to participate in the deliberations relating to the compensation of other officers, but would not be allowed to vote.

<sup>13</sup> Controlled companies would be exempt from this requirement, and a specific exception would exist to allow certain persons to serve on the compensation committee in exceptional and limited circumstances.

<sup>14</sup> Nothing in the rule exempts an issuer from the requirements of section 10A(m) under the Act, 15 U.S.C. 78j-1(m), and Rule 10A-3 thereunder.

<sup>15</sup> Pub. L. 107-204, 116 Stat. 745 (2002).

<sup>16</sup> The proposed rule confirms that the Exchange would not accept a plan that is designed to cure a deficiency under SEC Rule 10A-3 if the plan extends beyond the earlier of 12 months or the first annual shareholders' meeting (for circumstances beyond the reasonable control of an issuer) and 6 months (for other circumstances).