

Demutualization, this restriction on paying dividends will be removed and pursuant to Article FOURTH (a)(i) and (b) of the proposed Certificate of Incorporation the Phlx's stockholders will have all dividend and other distribution rights of a stockholder in a Delaware stock corporation (except as may be limited by the rights any preferred stock may have, once issued).

Section 30-4 of the proposed By-laws, however, will prohibit the payment of dividends from any revenues the Phlx derives from regulatory fines, fees or penalties.<sup>16</sup> The Exchange will apply this limitation to its net income, prospectively only, commencing with the fiscal year in which the Merger occurs.<sup>17</sup> To determine the amount of the limitation, the Phlx will first calculate: (i) The amount of regulatory fines, fees and penalties that it has accrued for the fiscal year in which the Merger occurs and later time periods (collectively, "Regulatory Fee Amount"),<sup>18</sup> and (ii) the amount of regulatory costs and expenses<sup>19</sup> accrued for the same time period (collectively, "Regulatory Cost Amount"). The

Exchange will determine the applicable restriction by determining the excess, if any, of the Regulatory Fee Amount over the Regulatory Cost Amount, and applying that to the amount of its net income for the fiscal year in which the Merger occurs and later periods. This restriction concerning the payment of dividends shall not prevent the Exchange from paying dividends from (i) capital, surplus or retained earnings of the Exchange which were (without regard to this restriction) available for the payment of dividends at the time of the Merger, or (ii) capital contributions or other capital items, in each case, no portion of which is attributable to Regulatory Fees.

Pursuant to Article FOURTH (b)(ii) of the proposed Certificate of Incorporation, the Class A Common Stock will carry with it the right to a contingent dividend (the "Contingent Dividend") payable in cash if a Liquidity Event occurs on or before the Dividend Termination Date. A "Liquidity Event" will be any investment of net cash proceeds in the Phlx's capital or that of one of its subsidiaries, either by means of a public offering or private placement of the common or preferred stock of the Phlx or the common stock or other securities of the subsidiary. The amount payable as the Contingent Dividend will depend, as follows, on the aggregate amount of net cash proceeds received by the Phlx and/or the subsidiary from all Liquidity Events occurring on or before the Dividend Termination Date:

- If the aggregate net cash proceeds will be at least \$50 million but less than \$100 million, the amount payable as a Contingent Dividend will be \$7,500 for each 100 shares of Class A Common Stock (\$3,787,500 in the aggregate).
- If the aggregate net cash proceeds will be at least \$100 million but less than \$150 million, the amount payable as a Contingent Dividend will be \$17,500 for each 100 shares of Class A Common Stock then outstanding (\$8,837,500 in the aggregate).
- If the aggregate net cash proceeds will be at least \$150 million, the amount payable as a Contingent Dividend will be \$29,700 for each 100 shares of Class A Common Stock then outstanding (\$14,998,500 million in the aggregate).

If no Liquidity Event occurs on or before the Dividend Termination Date, the right to receive Contingent Dividends will terminate without further action on behalf of the Exchange and the Class A Common Stock will be automatically converted into Class B Common Stock, as indicated above.

**Liquidation Rights and Preferences.** Currently, Owners have the right to

receive all distributions upon a liquidation of the Exchange, on the basis of their pro-rata interest in the Phlx, except as such right may be limited by certain rights of the holders of FCO participations.<sup>20</sup> After the proposed Demutualization, the Phlx common stock will have the right to receive all distributions upon a liquidation of the Phlx, subject to the rights of any preferred stock that may be issued in the future and by the rights of the holder of the Series A Preferred Stock, as described below.

#### *Voting Rights/Election of Directors.*

Currently, for the most part, non-Member Owners do not have voting rights under the Exchange's existing Certificate of Incorporation, By-laws and Rules with respect to any matters relating to the Exchange, with certain very limited exceptions.<sup>21</sup> After the Demutualization, pursuant to Article FOURTH (b)(iii) of the proposed Certificate of Incorporation, the Phlx common stockholders will vote on all matters on which stockholders are entitled to vote except for the election and removal of the On-Floor Governors and, in the case of a contest for the position, the selection of the On-Floor Vice Chairman of the Exchange.

The holders of the Class A Common Stock and Class B Common Stock will vote together as a single class on all matters, except that: (i) Any amendment, alteration or repeal of any of the provisions of the proposed Certificate of Incorporation that adversely affects the rights, powers or privileges of the Class A Common Stock (but not of the Class B Common Stock) will require the affirmative vote of a majority of the shares of the Class A Common Stock then outstanding, voting separately as a class; and (ii) any amendment, alteration or repeal of any of the provisions of the proposed Certificate of Incorporation that adversely affects the rights, powers or privileges of the Class B Common Stock (but not of the Class A Common Stock) will require the affirmative vote of a majority of the shares of Class B Common Stock then outstanding, voting separately as a class.

In addition, pursuant to Section 22-1 of the proposed By-laws, the By-Laws may be amended by the affirmative vote

<sup>20</sup> See Article SEVENTEENTH(c) of the existing Certificate of Incorporation.

<sup>21</sup> In addition, existing contractual arrangements between Owners of Seats or Member Organizations on the one hand and non-Owner Members on the other hand, such as leases or A-B-C agreements, in all but one case contain a provision that may entitle the Seat Owner or the Member Organization, respectively, to direct the Member's vote with respect to the Plan of Demutualization.

<sup>16</sup> For another example of such a restriction, see In the Matter of the Application of The International Securities Exchange LLC for Registration as a National Securities Exchange, Securities Exchange Act Release No. 42455 at Part III.A (February 24, 2000), 65 FR 11388. Securities Exchange Act Release No. 45803 (April 23, 2002), 67 FR 21306 (April 30, 2002) (Restructuring of the International Securities Exchange LLC ("ISE") from a limited liability company to a Delaware stockholder corporation and to "demutualize" by separating the equity interest in the ISE from members' trading rights).

<sup>17</sup> The rationales for applying this restriction prospectively are: (i) prior to the effectiveness of the Conversion Amendment, the Exchange's Certificate of Incorporation has provided that the Exchange is "not for profit" and has prohibited the payment of dividends altogether, and (ii) the Exchange has not compiled, and could not reasonably reconstruct, the information necessary for determining Regulatory Costs and Regulatory Fee Amounts (as defined herein) for prior periods.

<sup>18</sup> Regulatory fines and penalties will include such amounts imposed by the Business Conduct Committee and/or the Board, but not late charges or interest charged. Regulatory fees shall include the Exchange's fees relating to registered representative registration (currently, initial, renewal and transfer fees), as well as its off-floor trader (currently, initial and annual) and examinations fees.

<sup>19</sup> These amounts include costs reasonably related to the Exchange's regulatory function. Specifically, the Exchange intends to include the direct and allocated costs and expenses of the regulatory and enforcement groups as well as an allocation of the direct and allocated costs of technology, legal, compliance and other departments that support the regulatory and enforcement groups and work on regulatory projects. The Exchange's cost allocation methodology includes an employee's compensation and benefits-related costs and the overhead attributable to that employee, such as, for example, occupancy costs, office supplies, and administrative support and an allocation of management costs (again, adding, for example, the secretary's and managers' direct and allocated costs).