

of a majority of the entire Board of Governors, or by the affirmative vote of the holders of a majority of the shares of common stock then issued and outstanding, at any regular or special meeting of the Board of Governors or the stockholders (as the case may be). Unlike pursuant to Section 22-1 of the existing By-laws, after the Demutualization, Members (or Member Organizations) will have no right to vote in relation to By-law amendments or to propose By-law amendments. Such change is consistent with the Exchange's proposed post-Demutualization structure as a Delaware stock corporation in accordance with applicable Delaware law.

With respect to management equity awards post-Demutualization, Section 6-1 of the proposed By-laws provides that, the Exchange will not at any time adopt any stock incentive or option plan or arrangement, or any other equity based compensation plan or arrangement, for the benefit of its governors or officers that authorizes the issuance of stock, stock options or any other securities exercisable or exchangeable for or convertible into any equity interest in the Exchange representing more than 10% of the common stock outstanding at such time.

The proposed Article FOURTH (b)(iii)(A) provides also that each stockholder will be entitled to one vote for each share of common or preferred stock held of record on the books of the Phlx, subject to the applicable voting restrictions as described below.

Voting Limitations

In connection with the Demutualization, the Exchange proposes to include certain voting limitations as set forth in Article FOURTH(b)(iii)(B) of the proposed Certificate of Incorporation. The limitations will provide that, if any Person (as defined below) either alone or together with its Related Persons (as defined below), at any time owns of record or beneficially, whether directly or indirectly, more than 20% of the then outstanding shares of common stock (such shares of common stock in excess of such 20% limit being hereinafter referred to as "Excess Shares"), that Person and its Related Persons will not have any right to vote, or to give any consent or proxy with respect to, the Excess Shares, and the Excess Shares will be deemed not to be present for the purposes of determining whether a quorum is present at any meeting or vote of the stockholders of the Exchange. For purposes of the proposed Certificate of Incorporation, "Related Persons" means: (i) With respect to any

Person, all "affiliates" and "associates" of such Person (as such terms are defined in Rule 12b-2 under the Act);²² (ii) with respect to any natural person constituting a "member" (as such term is defined in the Act) of the Exchange, any broker or dealer with which such member is associated; and (iii) any two or more Persons that have any agreement, arrangement or understanding (whether or not in writing) to act together for the purpose of acquiring, holding, voting or disposing of shares of common stock. The term "Person" will be defined in the proposed Certificate of Incorporation to mean an individual, partnership (general or limited), joint-stock company, corporation, limited liability company, trust or unincorporated organization, and a government or agency or political subdivision thereof.

Notwithstanding the foregoing, a Person, either alone or together with its Related Persons, owning of record or beneficially, whether directly or indirectly, more than 20% of the then outstanding shares of common stock will be allowed to exercise voting rights, and give proxies and consents, with respect to those shares exceeding 20%, provided that: That Person (and its Related Persons owning any common stock) has delivered to the Board of Governors a notice in writing, not less than 45 days (or any shorter period to which the Board of Governors shall expressly consent) before the proposed exercise of its voting rights, of its intention to do so; and

- Before the intended exercise, the Board of Governors has adopted an amendment to the By-Laws adding a provision to expressly permit that Person's exercise of voting rights in excess of 20% and the amendment has been filed with the Commission as a proposed rule change under Section 19(b) of the Act²³ and has become effective.

The Board of Governors will not be permitted to adopt any amendment to the proposed By-laws described in the foregoing paragraph unless the Board of Governors has determined that: (x) The exercise of those voting rights by the Person in question and/or its Related Persons will not impair the Exchange's ability to discharge its responsibilities under the Act and the rules and regulations thereunder and is otherwise in the best interests of the Exchange and its stockholders; (y) the exercise of those voting rights by that Person and/or its Related Persons will not impair the

Commission's ability to enforce the Act; and (z) that Person and/or its relevant Related Persons are not subject to any applicable statutory disqualification. In making those determinations, the Board of Governors may impose on the Person in question and its Related Persons such conditions and restrictions as it may in its sole discretion deem necessary, appropriate or desirable in furtherance of the objectives of the Act and the governance of the Exchange. Under the proposed Certificate of Incorporation, however, in no event will a Person who is a Member of the Exchange or a Person affiliated with a Member Organization be permitted to vote shares representing in excess of 20% of the outstanding common stock.

These voting limitations, together with the ownership and notification requirements described below, are intended to establish a system of supervision and control to effectively prevent acquisition of voting power of or assertion of control over the Exchange without the approval of both the Board of Governors and the Commission. In addition, the proposed change to the Certificate of Incorporation is designed to prevent any Member or Member Organization from dominating the Exchange.

Ownership Limitations and Notification Requirements

No Person, either alone or together with its Related Persons, will be allowed to own, of record or beneficially, directly or indirectly, more than 40% of the then outstanding shares of common stock of the Phlx and to the extent any Person (or its Related Persons) purports to own more than 40% of the then outstanding shares of common stock, that Person (and its Related Persons) will not be allowed to exercise any of the rights or privileges incident to the ownership of shares of common stock with respect to the shares exceeding the 40% limit, unless:

- That Person (as well as its Related Persons) has delivered to the Board of Governors a notice in writing, not less than 45 days (or such shorter period to which the Board of Governors expressly consents) before the acquisition of that ownership, of its intention to acquire the ownership; and

- Before the intended exercise, the Board of Governors has adopted an amendment to the By-Laws, adding a provision to expressly permit that Person's ownership in excess of 40% and the amendment has been filed with the Commission as a proposed rule

²² 17 CFR 240.12b-2.

²³ 15 U.S.C. 78s(b).