

and 960.2 as well as from the commentary to Rule 803. Where applicable, the references will be either deleted in their entirety or will be replaced by references to the Certificate of Incorporation. The Exchange has not had a constitution since its incorporation in 1972 and, since that time, has been governed exclusively by its Certificate of Incorporation and By-laws.

References to the Exchange's President

The Exchange proposes to delete references to the Exchange's "President" from the Rules and replace such references with "Chairman of the Board of Governors." The Exchange has not established the position of a President and has no immediate plans to establish such a position after the Demutualization.

Participation in Mandatory Decimalization Testing

The Exchange proposes to delete Rule 650 in its entirety which relates to the mandatory participation of Members in certain programs concerning the testing of the Exchange's system in connection with decimalization. Such tests have been performed, and, therefore, Rule 650 has become obsolete.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act³⁸ in general and, in particular, furthers the objectives of Sections 6(b)(2),³⁹ 6(b)(3),⁴⁰ 6(b)(5)⁴¹ and 11(A)(a)(1)⁴² of the Act. Specifically, after careful consideration, the Exchange believes that the proposed permit structure to be established in connection with the Plan of Demutualization should further general access for any registered broker or dealer or natural person associated with a registered broker or dealer to become a member of the Phlx in accordance with Section 6(b)(2) of the Act.⁴³ Under its current structure, Seats on the Exchange, to which the right to be a member of the Exchange is linked, are limited in number to 505.⁴⁴ Under Section 12-1 of the proposed By-laws, the Exchange will be entitled to issue a potentially unlimited number of

permits⁴⁵ to qualified individuals. Consequently, the potential availability of a number of permits greater than 505 would allow more qualified brokers and dealers to become Phlx Members.

The Exchange further believes that the proposed provisions of the Certificate of Incorporation, the By-laws and the corresponding provisions of the Trust Agreement should assure the fair representation of its Members and Member Organizations in the selection of its Governors and the administration of its affairs by providing that the On-Floor Governors shall be elected by the Trust as a holder of the share of Series A Preferred Stock at the direction of the Member Organization Representatives who represent both the Member Organization that designated them, and, indirectly, the Member Organization's primarily affiliated Member(s). This election process, together with the composition of the Board and the various standing committees of the Board, should ensure fair representation by both upstairs Member Organizations and the Exchange floor in accordance with Section 6(b)(3) of the Act.⁴⁶ Article SIXTH of the proposed Certificate of Incorporation, together with Section 4-1 of the proposed By-laws, will continue to provide for five Governors of the Exchange to be "On-Floor" Governors, which will consist of:

- Two Governors who are industry Governors and are members⁴⁷ primarily engaged in business on the Exchange's equity floor;
- One Governor who is an industry Governor and is a Member primarily engaged in business as a specialist on the Exchange's equity options floor;
- One Governor who is an industry Governor and is a Member primarily engaged in business as a Registered Options Trader on the Exchange's equity options floor; and
- One Governor who is an industry Governor and is a Member primarily engaged in business on the Exchange's equity options floor as a floor broker.

There will also be five "Off-Floor" Governors who are industry Governors and are general partners, executive officers (vice president or above), or Members (or participants) associated with Member (or participant) Organizations which conduct a non-

member or non-participant public customer business and shall individually not be primarily engaged in business activities on the Exchange Floor. These Off-Floor Governors will be elected by the owners of the common stock of the Exchange. In addition, pursuant to the proposed By-laws, at least half of the members⁴⁸ of the Admissions Committee and the Foreign Currency Options Committee will be required to be Members, participants or persons affiliated with Member Organizations or participant organizations, and at least half of the members of the Options Committee and the Floor Procedure Committee will be required to be Members or persons affiliated with Member Organizations, which should ensure Member participation and influence over core governance decisions of the Exchange in areas of importance to the Members and Member Organizations. The Exchange also believes that the proposal is consistent with Section 6(b)(5) of the Act,⁴⁹ in that the Exchange will continue to offer a marketplace for the trading of securities that is designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, remove impediments to and perfect the mechanism for a free and open market and a national market system, as well as to protect investors and the public interest.

In general, the Exchange believes that the Plan of Demutualization is consistent with the findings of Congress expressed in Section 11A of the Act⁵⁰ that, *inter alia*, the securities markets are an important national asset which must be preserved and strengthened and that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure economically efficient execution of securities transactions. Under its current mutual structure, the Exchange will be severely hindered in its ability to address the financial and competitive challenges it is facing today. To keep pace with technological and other market changes, develop new products, react swiftly to competitors while continuing to comply with its statutory requirements as a self-regulatory organization, the Exchange believes that it will depend on both internal and external sources of capital. The Plan of Demutualization removes obstacles to third-party investments by creating a

³⁸ 15 U.S.C. 78f(b).

³⁹ 15 U.S.C. 78f(b)(2).

⁴⁰ 15 U.S.C. 78f(b)(3).

⁴¹ 15 U.S.C. 78f(b)(5).

⁴² 15 U.S.C. 78k(a)(1).

⁴³ 15 U.S.C. 78f(b)(2).

⁴⁴ One of the 505 Seats is held by SCCP pursuant to Section 12-3 of the existing By-laws and, therefore, is not otherwise available.

⁴⁵ Each series of permits issued by the Exchange may either be restricted or unlimited in number, as determined by the Exchange.

⁴⁶ 15 U.S.C. 78f(b)(3).

⁴⁷ Solely in connection with these composition requirements, "members" in each case includes general partners, executive officers (vice president and above) or Members associated with Member Organizations primarily engaged in the relevant business on the Exchange.

⁴⁸ Here, the term "member" is used merely to refer to persons serving on a committee.

⁴⁹ 15 U.S.C. 78f(b)(5).

⁵⁰ 15 U.S.C. 78k(A).