

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53721; File No. SR-NSX-2006-03)

April 25, 2006

Self-Regulatory Organizations; National Stock Exchange<sup>SM</sup>; Notice of Filing of a Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to the Demutualization of the National Stock Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on April 5, 2006, the National Stock Exchange<sup>SM</sup> (“NSX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On April 19, 2006, the NSX submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On April 25, 2006, the NSX submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 (“Amendment No. 1”) makes revisions to the proposed: Holdings Certificate of Incorporation, Sections (b)(iii)(B) and (C); Holdings By-Laws, Article III, Sections 3.1 and 3.4; NSX By-Laws, Article III, Section 3.2(b); and NSX Rule 2.10. In addition, Amendment No. 1 adds new proposed Section 3.6 to Article III of the Holdings By-Laws, requiring Holdings to take reasonable steps necessary to cause its officers, directors, and employees to consent to the applicability to them of Article III of the Holdings By-Laws. Finally, Amendment No. 1 makes corresponding changes to Item 3 of Form 19b-4 and Exhibit 1 to describe the effect of the foregoing Exhibit 5 revisions and also add a description of proposed NSX Rule 2.10.

<sup>4</sup> Amendment No. 2 (“Amendment No. 2”) made changes to Item 3 of Form 19b-4 and Exhibit 1, which changes have been incorporated into this notice.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The NSX proposes a series of changes to its corporate structure and governance documents to allow for the demutualization of NSX. NSX is proposing to “demutualize” by converting NSX from an Ohio non-stock, nonprofit membership corporation to a Delaware for-profit stock corporation. To effect the demutualization, NSX states that it has established a Delaware for-profit stock holding company, NSX Holdings, Inc. (“Holdings”) that would become the parent company and sole stockholder of NSX after the demutualization. NSX would become a Delaware for-profit stock corporation that would continue to engage in the business of operating a national securities exchange registered under Section 6 of the Act.<sup>5</sup> NSX states that it would continue to have self-regulatory responsibilities over its members, and would have its own Board of Directors that would manage NSX’s business and affairs.

The proposed rule change for implementing the demutualization includes the Amended and Restated Certificate of Incorporation of Holdings (the “Holdings Certificate of Incorporation”), Amended and Restated By-Laws of Holdings (the “Holdings By-Laws”), Amended and Restated Certificate of Incorporation of National Stock Exchange, Inc. (the “NSX Certificate of Incorporation”), Amended and Restated By-Laws of National Stock Exchange, Inc. (the “NSX By-Laws), and revised Rules of National Stock Exchange, Inc. (the “NSX Rules”), Exhibit 5 of NSX’s proposed rule change contains the NSX Certificate of Incorporation, the NSX By-Laws, and the NSX Rules, each marked to reflect changes from the current Articles of Incorporation, By-Laws, and Rules of the Exchange, as well as the new Holdings Certificate of

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<sup>5</sup> 15 U.S.C. 78f.



Incorporation and the Holdings Bylaws. A summary of these documents is provided below. The full text of Exhibit 5 is available on the Commission's Web site at [www.sec.gov](http://www.sec.gov),<sup>6</sup> the Web site of the Exchange at [www.nsx.com](http://www.nsx.com), at the principal office of the Exchange, and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Through this proposed rule change, as amended, the Exchange proposes a series of changes to the Exchange's corporate structure that would allow for the demutualization of the Exchange. The Exchange also proposes changes to its rules to implement a proposed equity trading permit structure, which would replace the existing structure of Exchange membership as a basis for trading rights.

a. Description of Demutualization Transaction

Currently, NSX is a non-stock, nonprofit Ohio corporation. NSX proposes to

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<sup>6</sup> The text of Exhibit 5 posted on the Commission's Web site is edited to incorporate the changes made in Amendment No. 1.

demutualize by reorganizing as a Delaware for-profit stock corporation that would be a direct and wholly-owned subsidiary of a new Delaware for-profit stock holding company, Holdings. To accomplish the demutualization, NSX has established (i) two new Delaware stock for-profit corporations: Holdings, a direct and wholly-owned subsidiary of NSX, and NSX Delaware Merger Sub, Inc. (“NSX Delaware Merger Sub”), a direct and wholly-owned subsidiary of Holdings, and (ii) one transitory Ohio stock for-profit corporation, NSX Ohio Merger Sub, Inc. (“NSX Ohio Merger Sub”), also a direct and wholly owned subsidiary of Holdings.<sup>7</sup>

Pursuant to an agreement and plan of merger, NSX would merge (“Merger #1”) with and into NSX Ohio Merger Sub, with NSX Ohio Merger Sub surviving the merger as an Ohio for-profit stock corporation that is a direct and wholly-owned subsidiary of Holdings. As a result of Merger #1, NSX Ohio Merger Sub will be the initial successor-in-interest to NSX.

Immediately following Merger #1, pursuant to a second agreement and plan of merger, NSX Ohio Merger Sub would merge (“Merger #2”) with and into NSX Delaware Merger Sub, with NSX Delaware Merger Sub surviving the merger as a Delaware for-profit stock corporation that is a direct and wholly-owned subsidiary of Holdings, and renamed National Stock Exchange, Inc. For ease of reference, the term “NSX” in this document will also refer to the Exchange as a Delaware for-profit stock corporation after the demutualization.

The Exchange states that upon completion of Merger #2, NSX, the Delaware for-profit stock corporation, would be, in effect, the successor-in-interest to NSX, the current Ohio non-

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<sup>7</sup> The Exchange states that the establishment of NSX Ohio Merger Sub and the process of demutualization through two mergers (as described more fully in this document) are necessitated because under Ohio law, NSX, as an Ohio nonprofit corporation, may not merge directly with and into a foreign for-profit corporation, such as NSX Delaware Merger Sub.

stock, nonprofit corporation, and would assume all of the assets and liabilities of the Exchange, including, without limitation, the adherence to, and the performance of, the undertakings under the Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 19(b) and 21C of the Securities Exchange Act of 1934, Making Findings and Imposing Sanctions, entered by the Commission on May 19, 2005<sup>8</sup> (the “Order”)<sup>9</sup>. NSX states that it would continue to engage in the business of operating a national securities exchange registered under Section 6 of the Act.<sup>10</sup>

Presently, the members of NSX hold certificates of proprietary membership in NSX and have a right to trade on the exchange operated by NSX.<sup>11</sup> On the effective date of the demutualization (the “Effective Date”), each member of NSX would receive 1,000 shares of

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<sup>8</sup> See Securities Exchange Act Release No. 51714.

<sup>9</sup> The Exchange has advised the staff that it may petition the Commission to modify the Order in light of the potential demutualization and the anticipated changes to the trading platform (for which Commission approval will be sought in a subsequent filing).

<sup>10</sup> 15 U.S.C. 78f. Following the demutualization, the Exchange states that earnings of NSX not retained in its business may be distributed to its parent, Holdings, and Holdings would be authorized to pay dividends to the stockholders of Holdings as and when they are declared by the Board of Directors of Holdings, but subject to the limitation under the proposed NSX By-Laws that any revenues received by NSX from regulatory fees or penalties may not be used to pay dividends. See proposed NSX By-Laws, Section 10.4.

<sup>11</sup> See infra note 16 and subsection c.(1)(b)(ii) for a description of Chicago Board Options Exchange, Incorporated’s interest in NSX.

Holdings Class A common stock<sup>12</sup> for the first certificate of proprietary membership of NSX held by the member and would receive a modestly discounted number of shares of Class A common stock (determined by a formula set forth in the Merger #1 merger agreement) for each additional certificate held. If, however, the total number of Class A shares to be received by a member that would hold an equity trading permit entitling it to trading access on the Exchange after the demutualization (an “ETP Holder”), together with any Class A shares to be received by that member’s Related Persons,<sup>13</sup> would exceed 20% of the total number of Class A shares

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<sup>12</sup> Holdings would be authorized to issue 1,100,000 shares of common stock having a par value of \$.0001 per share (of which 900,000 shares will be designated as Class A common stock, 100,000 shares will be designated as Class B common stock and 100,000 shares will be designated as Class C common stock) and 100,000 shares of preferred stock having a par value of \$.0001 per share. The Class A common stock would be entitled to one vote per share, absent a provision in the Holdings Certificate of Incorporation fixing or denying voting rights. Neither the Class B nor Class C common stock would be entitled to vote, unless the matter at issue would alter the rights, preferences, privileges or limitations (other than the right to vote) of that stock, respectively, without also altering the rights, preferences, privileges and limitations of the Class A common stock in an identical manner. See proposed Holdings Certificate of Incorporation, Article Fourth, and proposed Holdings By-Laws, Section 4.10.

<sup>13</sup> Under the proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (a)(ii), “Related Persons” means, with respect to any Person: (A) any “affiliate” of such Person (as such term is defined in Rule 12b-2 under the Act); (B) any other Person with which such first Person has any agreement, arrangement or understanding (whether or not in writing) to act together for the purpose of acquiring, voting, holding or disposing of shares of the capital stock of the Corporation; (C) in the case of a Person that is a company, corporation or similar entity, any executive officer (as defined under Rule 3b-7 under the Act) or director of such Person and, in the case of a Person that is a partnership or limited liability company, any general partner, managing member or manager of such Person, as applicable; (D) in the case of an ETP Holder, any Person that is associated with the ETP Holder (as determined using the definition of “person associated with a member” as defined under Section 3(a)(21) of the Act); (E) in the case of a Person that is an individual, any relative or spouse of such Person, or any relative of such spouse who has the same home as such Person or who is a director or officer of the Corporation or any of its parents or subsidiaries; (F) in the case of a Person that is an executive officer (as defined under Rule 3b-7 under the Act) or a director of a company, corporation or similar entity, such company, corporation or entity, as applicable; and (G) in the case of a

issued (and thus be in violation of an ownership limitation under the proposed Holdings Certificate of Incorporation<sup>14</sup>), that member would receive shares of Class C common stock<sup>15</sup> (which would generally not be entitled to the right to vote) in lieu of the shares of Class A common stock that are in excess of the 20% ownership limitation (and that the member would have received were the 20% ownership limitation not in effect under the proposed Holdings Certificate of Incorporation).

The Exchanges states that Chicago Board Options Exchange, Incorporated (“CBOE”) is not a member of NSX but owns certificates of proprietary membership in NSX. In the demutualization, CBOE would receive shares of Holdings Class B common stock (which is generally not entitled to the right to vote) in exchange for its certificates of proprietary membership in NSX that are subject to put and call rights under a Termination of Rights

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Person that is a general partner, managing member or manager of a partnership or limited liability company, such partnership or limited liability company, as applicable.

<sup>14</sup> This ownership limitation, in addition to other ownership, voting and transfer limitations, is described more fully later in this document.

<sup>15</sup> Each share of Class C common stock issued would be convertible, at the option of its holder, to one share of Class A common stock upon the satisfaction of certain notification and other requirements under the Holdings Certificate of Incorporation, but only to the extent that the conversion does not violate the limitations on ownership, transfer and voting applicable to Class A common stock under the Holdings Certificate of Incorporation, as more fully described in this document. See proposed Holdings Certificate of Incorporation, Article Fourth, paragraph (d).

Agreement between NSX and CBOE dated September 27, 2004 (the “TORA”),<sup>16</sup> and would receive shares of Holdings Class A common stock in exchange for the remainder of its certificates of proprietary membership.<sup>17</sup> The number of Class A and Class B shares received by CBOE would be based on the discount formula set forth in the Merger #1 merger agreement.

Following the demutualization, persons and entities who have been qualified for membership under the Exchange’s current Rules and, as a result, have access to the Exchange’s trading facilities would separately receive NSX equity trading permits (“ETPs”) entitling them to maintain their trading access to NSX and, as noted above, would be referred to as “ETP Holders.” Shares of Holdings capital stock and ETPs would not be tied together. The Exchange states that, as a result, following the demutualization, former NSX members would be able to sell the shares of Holdings capital stock they receive in connection with the demutualization, subject to the applicable restrictions in the proposed Holdings Certificate of Incorporation and Holdings By-Laws (as described more fully below), while retaining the ability to trade and operate on the Exchange pursuant to their ETPs. NSX states that any other person or entity that satisfies the

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<sup>16</sup> The Exchange states that, in 1986, NSX and CBOE entered into an agreement of affiliation pursuant to which CBOE obtained certificates of proprietary membership in NSX and certain rights associated with NSX, including the right to hold certain seats on the Board of Directors of NSX and certain put rights in connection with its certificates of proprietary membership in NSX. Under the TORA, the CBOE agreed to relinquish, upon certain terms, certain of these rights in exchange for cash payments and other undertakings. See Securities Exchange Act Release No. 34-51033 (January 13, 2005), 70 FR 3085 (January 19, 2005) (File No. SR-NSX-2004-12). See also supra subsection c(1)(b)(ii).

<sup>17</sup> Each share of Class B common stock would automatically convert to one share of Class A common stock upon its transfer, in accordance with the TORA, to a bona fide third party purchaser unaffiliated with CBOE. See proposed Holdings Certificate of Incorporation, Article Fourth, paragraph (c). NSX states that the Class B shares would be transferable only under extraordinary circumstances.

regulatory requirements set forth in the NSX Rules also would be able to obtain an ETP without regard to whether such person is a stockholder of Holdings.

b. Reasons for the Proposed Demutualization

There are several benefits that the Exchange believes may result from the demutualization of the Exchange.

The Exchange believes that, by adopting a for-profit approach with a view towards optimizing volume, efficiency, and liquidity in the markets the Exchange provides, it would be able to better meet the demands of, and provide value to, investors, while also preserving the ability to provide benefits and opportunities for ETP Holders. Additionally, NSX believes that its reorganization into a holding company structure could provide increased financing opportunities and better access to capital markets, which, as a result, could improve the Exchange's business and facilitate strategic initiatives. NSX also believes that the creation of Holdings as a for-profit stock corporation may present opportunities to enter into strategic alliances, while allowing the regulated Exchange business to remain separate.

The Exchange states that it remains committed to its role as a national securities exchange and does not believe that a change to a for-profit institution will undermine its responsibilities for regulating its marketplace. Indeed, as further described below, the Exchange believes that it has proposed specific provisions in the proposed Holdings By-Laws and NSX By-Laws that reinforce the ability of the Exchange to perform its self-regulatory functions. In addition, NSX states that it has retained in the proposed NSX By-Laws certain governance provisions of its current By-Laws (for example, the inclusion and governing structure of a Regulatory Oversight Committee) that were required by the Order.

c. Summary of Proposed Rule Change

The proposed rule change, as amended, is outlined below. In general, the proposed rule change, as amended, consists of the proposed Holdings Certificate of Incorporation and Holdings By-Laws and the proposed changes to the Articles of Incorporation and By-Laws of the Exchange that reflect governance and corporate form changes. NSX states that the proposed rule change also includes proposed changes to the Rules of the Exchange that are necessary to implement the proposed equity trading permit structure. NSX also proposes to move certain provisions in the current By-Laws of NSX respecting members, listing standards, and other matters not relating to the Exchange's corporate governance to the NSX Rules.

(1) Corporate Structure

(a) Holdings

Following the demutualization, Holdings would be the parent company and sole stockholder of NSX. NSX states that all of the issued and outstanding stock of Holdings initially would be owned by the former owners of certificates of proprietary membership in the Exchange.

As sole stockholder of NSX, Holdings would have the right to elect the Board of Directors of NSX, subject to certain provisions in the Holdings By-Laws that require Holdings to vote for certain persons nominated for ETP Holder Director positions and certain persons nominated for CBOE Director positions, in each case in accordance with the revised governance documents of NSX. The Holdings Certificate of Incorporation and the Holdings By-Laws would govern the activities of Holdings.

(i) Holdings Board of Directors

The business and affairs of Holdings would be managed by its Board of Directors (“Holdings Board”). The Holdings Board would consist of between 10 and 16 persons, as determined by the Holdings Board, one of which shall be the Chief Executive Officer (“CEO”) of Holdings. The Holdings Board would initially have 13 directors after the demutualization. No person that is subject to any “statutory disqualification” (within the meaning of Section 3(a)(39) of the Act) may be a director of Holdings.<sup>18</sup>

The directors of Holdings would be divided into three classes, which would be as nearly equal in number as the total number of directors then constituting the entire Holdings Board. After completion of an initial phase-in schedule, the directors of Holdings would serve staggered three-year terms, with the term of office of one class expiring each year.<sup>19</sup>

The Holdings Board would elect its Chairman from among the directors on the Holdings Board, and may elect a vice-chairman to perform the functions of the Chairman in his or her absence.<sup>20</sup>

At each annual meeting of the stockholders of Holdings at which a quorum is present, the individuals receiving a plurality of the votes cast of the Class A shares would be elected directors of Holdings.<sup>21</sup> At an election of directors, each Holdings stockholder would be entitled

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<sup>18</sup> See proposed Holdings Certificate of Incorporation, Article Sixth, Section (a), and proposed Holdings By-Laws, Sections 2.2(a) and (b).

<sup>19</sup> See proposed Holdings Certificate of Incorporation, Article Sixth, Section (b), and proposed Holdings By-Laws, Section 2.2(c).

<sup>20</sup> See proposed Holdings By-Laws, Section 2.3(a).

<sup>21</sup> See proposed Holdings By-Laws, Section 4.8.

to one vote for each share of Class A common stock owned by that stockholder.<sup>22</sup> Class B and Class C shares shall not be entitled to vote at an election of directors.<sup>23</sup>

In most cases, vacancies on the Holdings Board would be filled by the remaining directors of Holdings. If the vacancy has resulted from a director being removed for cause by the stockholders of Holdings, however, that vacancy may be filled by the stockholders of Holdings at the same meeting at which the director was removed. Any director appointed to fill a vacancy will serve until the expiration of the term of office of the replaced director or until the end of the term for a newly-created directorship.<sup>24</sup>

(ii) Committees of Holdings

The Holdings Board would have an Audit Committee, a Governance and Nominating Committee, and such other committees that the Holdings Board establishes.<sup>25</sup> The Chairman of the Holdings Board would appoint the members of all committees of the Holdings Board, and may remove any member so appointed, subject to the approval of the Holdings Board.<sup>26</sup> Each committee would have the authority and duties prescribed for it in the Holdings By-Laws or by the Holdings Board.<sup>27</sup>

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<sup>22</sup> See proposed Holdings Certificate of Incorporation, Article Fourth, paragraph (b), and proposed Holdings By-Laws, Section 4.10.

<sup>23</sup> See proposed Holdings Certificate of Incorporation, Article Fourth, paragraphs (c) and (d).

<sup>24</sup> See proposed Holdings By-Laws, Section 2.4.

<sup>25</sup> See proposed Holdings By-Laws, Section 5.1.

<sup>26</sup> See proposed Holdings By-Laws, Section 5.2.

<sup>27</sup> See proposed Holdings By-Laws, Section 5.3.

(iii) Officers of Holdings

The officers of Holdings would be a CEO, a President, a Secretary, a Treasurer, and such other officers as the Holdings Board determines.<sup>28</sup> The CEO would be responsible to the Holdings Board for management of the business affairs of Holdings.<sup>29</sup> The officers of Holdings would have the duties and authority set forth in the Holdings By-Laws or given to them by the Holdings Board, and in the case of the President, the Secretary, and the Treasurer, given to them by the Chief Executive Officer.<sup>30</sup> Any two or more offices may be held by the same person, except that the Secretary may not also serve as the CEO or the President. No person that is subject to any “statutory disqualification” (within the meaning of Section 3(a)(39) of the Act) may be an officer of Holdings.<sup>31</sup>

(iv) Stockholder Restrictions

The Holdings Certificate of Incorporation and the Holdings By-Laws place certain restrictions on the ability to transfer, own, and vote the capital stock of Holdings.

(1) Restrictions on voting

The Holdings Certificate of Incorporation prohibits any Person,<sup>32</sup> either alone or together with its Related Persons, from (a) voting or giving a proxy or consent with respect to shares representing more than 20% of the voting power of the then-issued and outstanding capital stock

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<sup>28</sup> See proposed Holdings By-Laws, Section 6.1.

<sup>29</sup> See proposed Holdings By-Laws, Section 6.4.

<sup>30</sup> See proposed Holdings By-Laws, Sections 6.1, 6.4, 6.5, 6.6, and 6.7.

<sup>31</sup> See proposed Holdings By-Laws, Section 6.1.

<sup>32</sup> Article Fifth of the proposed Holdings Certificate of Incorporation defines a “Person” to mean “an individual, partnership (general or limited), joint stock company, corporation, limited liability company, trust or unincorporated organization, or any governmental entity or agency or political subdivision thereof.”

of Holdings; or (b) entering into any agreement, plan, or arrangement that would result in the shares of Holdings subject to that agreement, plan, or arrangement not being voted on a matter, or any proxy relating thereto being withheld, where the effect of that agreement, plan, or arrangement would be to enable any Person, alone or together with its Related Persons, to obtain more than 20% of the voting power of the then-issued and outstanding capital stock of Holdings.<sup>33</sup>

This restriction would not apply to the Class B or Class C common stock and, as to the Class A common stock owned by Persons other than ETP Holders and their Related Persons, may be waived by Holdings Board pursuant to a resolution adopted by the Holdings Board.<sup>34</sup> Before adopting such resolution, however, the Holdings Board must determine that, among other things, the waiver of the voting limitation will not impair the ability of NSX to carry out its functions and responsibilities under the Act and the rules and regulations promulgated thereunder, and will not impair the Commission’s ability to enforce the Act and the rules and regulations promulgated thereunder.<sup>35</sup> In addition, the Holdings Board also must determine that a Person and its Related Persons that would vote more than 20% of the outstanding stock of Holdings are not subject to an applicable “statutory disqualification” (within the meaning of Section 3(a)(39) of the Act).<sup>36</sup> Finally, any resolution of the Holdings Board that would permit a

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<sup>33</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(ii)(C).

<sup>34</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraphs (b)(iii)(A) and (B). See Amendment No. 1, supra note 3.

<sup>35</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(iii)(B).

<sup>36</sup> 15 U.S.C. 78c(a)(39); See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(iv).

Person to vote more than 20% of the outstanding stock of Holdings must be filed with and approved by the Commission before it becomes effective.<sup>37</sup>

(2) Restrictions on ownership

Under the proposed Holdings Certificate of Incorporation, no Person, either alone or together with its Related Persons, may own shares constituting more than 40% of any class of capital stock of Holdings (other than a class of stock without general voting rights).<sup>38</sup> The Holdings Board may waive this ownership limitation pursuant to a resolution adopted by the Holdings Board. Before adopting such resolution, however, the Holdings Board must determine that, among other things, the waiver of the ownership limitation would not impair the ability of NSX to carry out its functions and responsibilities under the Act and the rules and regulations promulgated thereunder and would not impair the Commission’s ability to enforce the Act and the rules and regulations promulgated thereunder.<sup>39</sup>

In addition, the Holdings Board also must determine that any Person and its Related Persons that would own more than 40% of any class of capital stock of Holdings are not subject to any applicable “statutory disqualification” (within the meaning of Section 3(a)(39) of the Act).<sup>40</sup> Finally, any Holdings Board resolution that would permit ownership of Holdings capital

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<sup>37</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(iii)(B).

<sup>38</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraphs (b)(ii)(A) and (b)(iii)(A).

<sup>39</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(iii)(B).

<sup>40</sup> 15 U.S.C. 78c(a)(39); see proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(iv).

stock in excess of the ownership limitation described above must be filed with and approved by the Commission before it becomes effective.<sup>41</sup>

In addition to the ownership restriction described above, no ETP Holder, whether alone or together with its Related Persons, may own shares constituting more than 20% of any class of capital stock of Holdings.<sup>42</sup> However, this ownership restriction would not apply to any ETP Holder, with respect to shares of Class C common stock of Holdings issued to the ETP Holder in connection with, and from the date of, the demutualization of NSX so long as the ETP Holder becomes compliant with the ownership limitation promptly after such issuance.<sup>43</sup>

(3) Other stockholder ownership and voting restriction requirements

The Exchange states that the proposed Holdings Certificate of Incorporation contains several provisions that would enable Holdings to enforce restrictions on the ownership and voting of Holdings capital stock described in the preceding section. Specifically, if a stockholder purports to sell, transfer, assign, or pledge to any Person (other than Holdings) any shares of Holdings that would violate the ownership restrictions, Holdings would record on its books the transfer of only the number of shares that would not violate the restrictions and would treat the remaining shares as owned by the purported transferor, for all purposes, including, without limitation, voting, payment of dividends, and distributions.<sup>44</sup>

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<sup>41</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraphs (b)(iii)(B) and (C).

<sup>42</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(ii)(B).

<sup>43</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(iii)(C). See Amendment No. 1, supra note 3.

<sup>44</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (d).

In addition, if any stockholder purports to vote, or to grant any proxy or enter into any agreement, plan, or arrangement relating to the voting of shares that would violate the voting restrictions, Holdings would not honor such vote, proxy, or agreement, plan, or other arrangement to the extent that the restrictions would be violated, and any shares subject to that arrangement would not be entitled to be voted to the extent of the violation.<sup>45</sup> Further, if any stockholder purports to sell, transfer, assign, pledge, vote, or own any shares that would violate the ownership and voting restrictions, Holdings would have the right to, and would generally be required to promptly, redeem such shares at a price equal to the par value of the shares.<sup>46</sup> Also, a stockholder that alone or together with its Related Persons owns five percent or more of the then outstanding shares of the capital stock of Holdings entitled to vote in an election of directors must, upon acquiring knowledge of such ownership, immediately give the Holdings Board written notice of such ownership.<sup>47</sup> Holdings may also require any Person reasonably believed to be subject to and in violation of the voting and ownership restrictions to provide to Holdings information relating to such potential violation.<sup>48</sup>

(4) Restrictions on transfer

Members, former members, and other equity owners of NSX who receive shares of capital stock of Holdings in the demutualization may not sell, transfer, or otherwise dispose of

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Id.

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See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (e).

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See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (c)(i). Such notice must also be updated under certain circumstances. See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (c)(ii).

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See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (c)(iii).

those shares for the first thirty days following their issuance, unless the Holdings Board waives this transfer restriction.<sup>49</sup>

Also, unless waived by the Holdings Board or pursuant to a redemption of shares by Holdings, each stockholder of Holdings would be prohibited from selling, transferring, or otherwise disposing of common shares of Holdings except in amounts of at least 1,000 shares (unless the stockholder is transferring all shares owned), and no stockholder would be permitted to transfer any capital stock of Holdings (other than pursuant to a redemption of shares by Holdings) until all amounts due and owing from that stockholder to NSX have been paid.<sup>50</sup>

In the event that a stockholder desires to transfer shares of capital stock of Holdings to any person (other than an affiliate of the stockholder or to another holder of the same class of capital stock) prior to January 1, 2011, Holdings would have a right of first refusal permitting it to purchase those shares, except for transfers by bequest, operation of law, or judicial decree under certain circumstances.<sup>51</sup>

In addition to these transfer restrictions, the Exchange states that shares of Holdings would be “restricted securities” under the Securities Act of 1933 (“Securities Act”) and only may be transferred pursuant to an effective registration statement under the Securities Act and in accordance with applicable state securities laws or, if an exemption from registration is available, upon delivery to Holdings of a satisfactory opinion of counsel that such transfer may be effected pursuant to the exemption. In addition, counsel to Holdings may require delivery of

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<sup>49</sup> See proposed Holdings Certificate of Incorporation, Article Fifth, paragraph (b)(i).

<sup>50</sup> See proposed Holdings By-Laws, Sections 9.4 and 9.5(b).

<sup>51</sup> See proposed Holdings By-Laws, Section 9.6.

documentation to ensure that the transfer complies with the Securities Act and state securities laws before such transfer is effected.<sup>52</sup> The Exchange states that Holdings has no present intention to register its common stock under the Securities Act or the Act, and, unless waived in writing by the Holdings Board, no transfer would be honored by Holdings that would cause Holdings to have to do so or to become subject to the reporting requirements of the Act.<sup>53</sup>

(v) Self-Regulatory Function and Oversight.

NSX states that the Holdings By-Laws contain various provisions designed to protect the independence of the self-regulatory function of NSX and to clarify the Commission's oversight responsibilities. For example, under the Holdings By-Laws, for as long as Holdings controls NSX, the Holdings Board and the directors, officers, and employees of Holdings must give due regard to the preservation of the independence of the self-regulatory function of NSX and to its obligations to investors and the general public, and are prohibited from taking actions that would interfere with the effectuation of decisions by the Board of Directors of NSX ("NSX Board") relating to NSX's regulatory functions, including disciplinary matters, or which would interfere with NSX's ability to carry out its responsibilities under the Act.<sup>54</sup>

The Holdings By-Laws also contain a specific requirement that all books and records of NSX, and the information contained therein, that reflect confidential information pertaining to the self-regulatory function of NSX, which come into the possession of Holdings, must be retained in confidence by Holdings and its Board, officers, employees, and agents, and must not

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<sup>52</sup> See proposed Holdings By-Laws, Section 9.5(a).

<sup>53</sup> See proposed Holdings By-Laws, Section 9.5(c).

<sup>54</sup> See proposed Holdings By-Laws, Section 3.1.

be used for any non-regulatory purposes.<sup>55</sup> In addition, the Holdings By-Laws provide that, to the extent they are related to the activities of NSX, the books, records, premises, officers, directors, agents, and employees of Holdings are deemed to be the books, records, premises, officers, directors, agents, and employees of NSX for the purposes of, and subject to oversight pursuant to, the Act.<sup>56</sup>

NSX states that, pursuant to the Holdings By-Laws, Holdings must comply with the federal securities laws and the rules and regulations promulgated thereunder. With regard to the Commission's ability to oversee the activities of Holdings, the Exchange states that the Holdings By-Laws also provide that Holdings must cooperate with the Commission and NSX pursuant to and to the extent of their respective regulatory authority, and that the officers, directors, employees, and agents of Holdings, by virtue of their acceptance of such position, are deemed to agree to cooperate with the Commission and NSX in respect of the Commission's oversight responsibilities regarding NSX and the self-regulatory function and responsibilities of NSX.<sup>57</sup> In addition, the Holdings By-Laws provide that Holdings, its officers, directors, employees and agents, by virtue of their acceptance of such positions, will be deemed to irrevocably submit to the jurisdiction of the U.S. federal courts, the Commission and NSX, for the purpose of any suit, action, or proceeding pursuant to the U.S. federal securities laws, and the rules and regulations

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<sup>55</sup> See proposed Holdings By-Laws, Section 3.2.

<sup>56</sup> See proposed Holdings By-Laws, Section 3.3. This provision also requires Holdings to maintain its books and records in the United States.

<sup>57</sup> See proposed Holdings By-Laws, Section 3.4. See Amendment No. 1, supra note 3.

promulgated thereunder, arising out of, or relating to, the activities of NSX.<sup>58</sup>

Finally, the Holdings Certificate of Incorporation and the Holdings By-Laws provide that, as long as Holdings controls NSX, before any change to the Holdings Certificate of Incorporation or the Holdings By-Laws, respectively, will be effective, such change must be submitted to the NSX Board, and if the NSX Board determines that the change must be filed with or filed with and approved by the Commission before it may be effective, the change will not be effective until it is filed with, or filed with and approved by, the Commission, as the case may be.<sup>59</sup>

(b) NSX

Following the demutualization, NSX would become a Delaware for-profit stock corporation, with the authority to issue 1,000 shares of common stock. At all times, all of the voting stock of NSX would be owned by Holdings.<sup>60</sup> NSX states that it would continue to be the entity registered as a national securities exchange under Section 6 of the Act<sup>61</sup> and, accordingly,

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<sup>58</sup> See proposed Holdings By-Laws, Section 3.5. Pursuant to the Holdings By-Laws, Holdings would be required to take reasonable steps necessary to cause its officers, directors, and employees, prior to accepting a position as an officer, director, or employee, as applicable, of Holdings, to consent in writing to the applicability to them of the provisions described in this and the preceding two paragraphs with respect to their activities related to NSX; see Amendment No. 1, supra note 3.

<sup>59</sup> See proposed Holdings Certificate of Incorporation, Article Twelfth, and proposed Holdings By-Laws, Article VIII. These provisions additionally state, respectively, that (i) any change to the proposed Holdings Certificate of Incorporation must also be first approved by the Holdings Board and (ii) any change to the proposed Holdings By-Laws may be made by either the stockholders of Holdings or the Holdings Board. In addition, under Article Fourth, paragraph (e) of the proposed Holdings Certificate of Incorporation, holders of preferred stock (voting separately as single class) must approve any change to the Holdings Certificate of Incorporation that would change the terms of that preferred stock. No preferred stock is currently issued and outstanding.

<sup>60</sup> See proposed NSX Certificate of Incorporation, Article Fourth.

<sup>61</sup> 15 U.S.C. 78f.

NSX would continue to be a self-regulatory organization (“SRO”). Moreover, NSX states that it would continue to adhere to the undertakings in the Order<sup>62</sup> including, without limitation, the structure provisions of a Regulatory Oversight Committee, the separation of the regulatory functions from the commercial interests of the Exchange, and the retention of third parties to review the Exchange’s regulatory functions.

(i) Governing Documents and NSX Rules

The proposed NSX Certificate of Incorporation,<sup>63</sup> NSX By-Laws, and NSX Rules (with the proposed changes described in this document) would govern the activities of NSX. NSX states that these rules and governance documents are proposed to reflect, among other things, NSX’s status as a wholly-owned subsidiary of Holdings, its management by the NSX Board and its designated officers, and its self-regulatory responsibilities pursuant to NSX’s registration under Section 6 of the Act. NSX states that it has designed these proposed governance documents to be generally consistent with NSX’s current governance structure, with certain changes based upon its proposed new corporate form. NSX states that none of these proposed changes are in contravention of the Order.

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<sup>62</sup> See supra note 9.

<sup>63</sup> Due to differences in terminology between Ohio and Delaware law, the Exchange’s Articles of Incorporation are proposed to be renamed its “Certificate of Incorporation.”

(ii) Board of Directors

After the demutualization, the NSX Board would initially consist of 13 directors. The NSX Board would be initially comprised of the CEO of NSX, 3 ETP Holder Directors,<sup>64</sup> 7 Independent Directors,<sup>65</sup> and 2 directors who are executive officers of CBOE, its members,<sup>66</sup> or executive officers of CBOE member organizations.<sup>67</sup> This composition is consistent with the composition of the Exchange's current Board of Directors, which consists of the CEO of NSX, 3 proprietary members or executive officers of proprietary members, 7 independent directors, and 2 executive officers of CBOE, CBOE members, or executive officers of CBOE member organizations.

Under the proposed rule change, the NSX Board may by resolution increase its size to up to 20 directors. Directors added to the NSX Board to fill these new director positions will be (i) Independent Directors, to the extent necessary for the NSX Board to include at least 50% Independent Directors; (ii) ETP Holder Directors, to the extent necessary for the NSX Board to

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<sup>64</sup> An ETP Holder Director is defined under the proposed NSX By-Laws as a director who is an ETP Holder or a director, officer, managing member or partner of an entity that is an ETP Holder. See proposed NSX By-Laws, Section 1.1(E)(2).

<sup>65</sup> An Independent Director is defined under the proposed NSX By-Laws as a member of the NSX Board that the NSX Board has determined to have no material relationship with NSX or any affiliate of NSX, or any ETP Holder or any affiliate of any such ETP Holder, other than as a member of the NSX Board. See proposed NSX By-Laws, Section 1.1(I)(1). This definition is consistent with the definition of Independent Director in the current By-Laws of NSX. NSX states that at least one Independent Director will be representative of investors; see Amendment No. 1, supra note 3.

<sup>66</sup> A CBOE member is defined under the proposed NSX By-Laws as an individual CBOE member or a CBOE member organization that is a regular member or special member of CBOE (as such terms are described in the Constitution of the CBOE), as such CBOE members may exist from time to time. See proposed NSX By-Laws, Section 1.1(C)(2).

<sup>67</sup> See proposed NSX By-Laws, Section 3.2(a).

include at least 20% ETP Holder Directors; and (iii) persons who do not qualify as Independent Directors (“At-Large Directors”), for the remainder of the positions added to the NSX Board that are not filled with Independent Directors or ETP Holder Directors pursuant to clauses (i) and (ii) above. At all times, the NSX Board must include the CEO of NSX, at least 50% Independent Directors and 3 ETP Holder Directors (or such greater number of ETP Holder Directors as is necessary to comprise at least 20% of the NSX Board).<sup>68</sup>

NSX states that, consistent with the current By-Laws of NSX, no two or more directors under the proposed NSX By-Laws may be partners, officers, or directors of the same person or be affiliated with the same person, unless such affiliation is with a national securities exchange or Holdings.<sup>69</sup> Directors of NSX other than the CEO and the CBOE Directors would be divided into three classes, consisting as nearly as possible of equal numbers of directors.<sup>70</sup> After completion of an initial phase-in schedule, these directors would serve for staggered three-year terms, with the term of one class expiring each year. The CEO’s appointment as a director would coincide with his or her term as CEO of NSX.<sup>71</sup> The CBOE Directors would each serve a one year term.<sup>72</sup>

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<sup>68</sup> See proposed NSX By-Laws, Section 3.2(b); see Amendment No. 1, supra note 3.

<sup>69</sup> See proposed NSX By-Laws, Section 3.2(c). NSX states that the current By-Laws of NSX prohibit two or more directors from being partners, officers, or directors of the same person or affiliated with the same person, except for affiliations with national securities exchanges.

<sup>70</sup> See proposed NSX By-Laws, Section 3.4. NSX states that this board framework is consistent with the current By-Laws of NSX.

<sup>71</sup> See proposed NSX By-Laws, Section 3.4(a). NSX states that this provision is consistent with the current By-Laws of NSX.

<sup>72</sup> See proposed NSX By-Laws, Section 3.4(d). NSX states that this provision is consistent with the current By-Laws of NSX.

NSX states that, consistent with the current By-Laws of NSX, under the proposed NSX By-Laws, the NSX Board is subject to change upon certain events in accordance with the TORA between CBOE and NSX.<sup>73</sup> Under the TORA, CBOE was provided with 4 put rights to transfer its equity interests in NSX to NSX and NSX was provided with 4 call rights on those equity interests. NSX states that, as of March 10, 2006, the first of these put rights was exercised by CBOE, decreasing the number of director positions of NSX filled by a representative of CBOE from 3 to 2 and increasing the number of positions filled by independent directors from 6 to 7. NSX states that, under the proposed NSX By-Laws:

- On the second closing of a put or call under the TORA, the number of positions on the NSX Board filled by representatives of CBOE will be reduced from 2 to 1. The vacant director position must be filled by an At-Large Director, unless an Independent Director is needed to maintain at least 50% Independent Directors on the NSX Board.<sup>74</sup>
- On the earlier of the date CBOE owns less than 5% of the outstanding capital stock of Holdings or the third anniversary of the fourth closing of a put or call under the TORA, CBOE's appointed positions on the NSX board will decrease to zero. The vacant director position must be filled with an At-Large Director,

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<sup>73</sup> See generally proposed NSX By-Laws, Section 3.3. The current Board of Directors of NSX is also subject to these provisions of the TORA.

<sup>74</sup> See proposed NSX By-Laws, Section 3.3(a). The current By-Laws of NSX permit the vacant director position to be filled by an independent director or a proprietary member director.

unless an Independent Director is needed to maintain at least 50% Independent Directors on the NSX Board.<sup>75</sup>

The NSX Board would elect its Chairman from among the directors of the NSX Board. The Chairman of the NSX Board may also serve as the CEO and President of NSX, but may hold no other offices in NSX. Unless the Chairman also serves as the CEO of NSX, the NSX Board must elect the Chairman from among the Independent Directors of the NSX Board.<sup>76</sup>

In most cases, vacancies on the NSX Board would be filled by the remaining directors of NSX. If the vacancy has resulted from a director being removed for cause by the stockholders of NSX, however, that vacancy may be filled by the stockholder of NSX (i.e., Holdings) at the same meeting at which the director was removed. Any director appointed to fill a vacancy would serve until the expiration of the term of office of the replaced director or until the end of the term for a newly-created directorship.<sup>77</sup>

(iii) Nomination and Election of Directors

After the formation of the initial NSX Board, the NSX Governance and Nominating Committee would nominate directors for each director position (other than CBOE director positions) standing for election at the annual meeting of stockholders that year. Candidates for CBOE Directors would be nominated by the Board of Directors of CBOE at its annual meeting or within 20 days of NSX's annual stockholders' meeting. Because ETPs are not equity interests in NSX, ETP Holders are not entitled to directly elect members of the NSX Board. Rather,

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<sup>75</sup> See proposed NSX By-Laws, Section 3.3(b). The current By-Laws of NSX permit the vacant director position to be filled by an independent director or a proprietary member director.

<sup>76</sup> See proposed NSX By-Laws, Section 3.6.

Holdings, as the sole stockholder of NSX, would have the sole right and the obligation to vote for the directors of the NSX Board.<sup>78</sup> However, NSX states that, to ensure that ETP Holders are afforded fair representation as required under Section 6(b)(3) of the Act,<sup>79</sup> NSX has proposed a procedure, similar to one already in place under the current By-Laws of NSX, whereby ETP Holder Directors and ETP Holders would be involved in the selection of ETP Holder Director nominees.<sup>80</sup>

Specifically, the ETP Holder Director Nominating Committee of NSX (which would be composed solely of ETP Holder Directors and/or ETP Holder representatives) would consult with the NSX Governance and Nominating Committee, the Chairman, and the CEO of NSX and solicit comments from ETP Holders for the purpose of approving and submitting names of ETP Holder Director candidates. These initial candidates for nomination would be announced to ETP Holders, who would then have the opportunity to identify additional candidates for nomination to ETP Holder Director positions by submitting a petition signed by at least ten percent of the ETP Holders. An ETP Holder may endorse as many candidates as there are ETP Holder Director positions to be filled. If no petitions are submitted within the time frame prescribed by the NSX By-Laws, the initial candidates approved and submitted by the ETP Holder Director Nominating Committee would be nominated. If one or more valid petitions are submitted, the

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<sup>77</sup> See proposed NSX By-Laws, Section 3.7(a). NSX states that this provision is consistent with, and expands upon, the current By-Laws of NSX.

<sup>78</sup> Under Section 10.5(a) of the proposed By-Laws of Holdings, the power to vote the stock of NSX held by Holdings would be in the CEO of Holdings, unless the Holdings Board instructs otherwise or unless the Holdings Board or the CEO of Holdings confers such power on another person.

<sup>79</sup> 15 U.S.C. 78f(b)(3).

<sup>80</sup> See proposed NSX By-Laws, Section 3.5.

ETP Holders would vote on the entire group of potential candidates, and the individuals receiving the largest number of votes would be the ETP Holder Director nominees.<sup>81</sup> NSX states that, under the Holdings By-Laws, the person with the power to vote the stock of NSX held by Holdings must vote to elect the ETP Holder Director candidates nominated in accordance with the foregoing procedure.<sup>82</sup>

(iv) Committees

The NSX Board would have the following committees: (1) a Business Conduct Committee; (2) a Securities Committee; (3) an Appeals Committee; (4) a Governance and Nominating Committee; (5) an ETP Holder Director Nominating Committee; (6) a Regulatory Oversight Committee; (7) a Compensation Committee; (8) an Executive Committee; and (9) an

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<sup>81</sup> Under Section 3.5(e) of the proposed NSX By-Laws, each ETP Holder, regardless of its affiliation with other ETP Holders, will have one vote with respect to each ETP Holder Director position to be filled, but may not cast such votes cumulatively. NSX states that, these nomination provisions are generally consistent with the current By-Laws of NSX. Under the current By-Laws of NSX, independent directors are nominated by the Nominating Committee subject to approval by the Board of Directors of NSX. The CBOE directors are elected by the Board of Directors of CBOE at its January meeting or as soon thereafter as possible. The current By-Laws of NSX also contain a procedure for proprietary member director nominations, whereby one proprietary member director candidate is nominated by the Nominating Committee and additional proprietary member director candidates may be nominated by a petition signed by ten percent or more of the proprietary members. At an annual election during the annual meeting of members, the proprietary members vote for the proprietary member directors among the nominated candidates.

<sup>82</sup> Under Section 10.5(b) of the proposed By-Laws of Holdings, the person with power to vote the stock of NSX held by Holdings must vote for the ETP Holder Directors and CBOE Directors nominated in accordance with the proposed NSX Certificate of Incorporation and NSX By-Laws.

Audit Committee.<sup>83</sup> The NSX Board may establish other committees from time to time. Each committee would have the authority and responsibilities prescribed for it in the NSX By-Laws, the rules of the Exchange, or by the NSX Board.<sup>84</sup>

The Chairman of the NSX Board would appoint, and may remove, the members of the committees, subject to the approval of the NSX Board.<sup>85</sup> Each committee must have at least 3 members.<sup>86</sup> The Executive Committee would have the powers that the NSX Board delegates to it, except the power to change the membership of, or fill vacancies in, the Executive Committee.<sup>87</sup> The ETP Holder Director Nominating Committee would have the power to approve and submit names of candidates for election to the position of ETP Holder Director in accordance with the NSX By-Laws.<sup>88</sup> The Regulatory Oversight Committee shall oversee all of the regulatory functions and responsibilities of NSX and advise the NSX Board on regulatory matters.<sup>89</sup> The Regulatory Oversight Committee's duties and responsibilities are outlined in its charter. NSX states that the Regulatory Oversight Committee's charter following

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<sup>83</sup> See proposed NSX By-Laws, Section 5.1. NSX states that, under the current By-Laws of NSX, the standing committees of NSX are a Membership Committee, a Business Conduct Committee, a Securities Committee, an Appeals Committee, a Nominating Committee, and a Regulatory Oversight Committee.

<sup>84</sup> See proposed NSX By-Laws, Sections 5.1 and 5.3.

<sup>85</sup> Under Section 5.2 of the proposed NSX By-Laws, the terms of committee members are subject to the appointment and removal process of the Chairman and NSX Board. Under the current By-Laws of NSX, terms of committee members expire at the regular meeting of the Board of Directors of NSX after the corresponding annual election meeting, except for members of the Nominating Committee whose stated term is 1 year.

<sup>86</sup> See proposed NSX By-Laws, Section 5.2. This provision is consistent with the current By-Laws of NSX.

<sup>87</sup> See proposed NSX By-Laws, Section 5.5. This provision is consistent with the current By-Laws of NSX.

<sup>88</sup> See proposed NSX By-Laws, Section 5.7.

demutualization would be the same as the charter previously filed with the Commission, and is consistent with the terms of the Order.<sup>90</sup>

(v) Management

The officers of NSX would be a CEO, a President, a Chief Regulatory Officer, a Secretary, and a Treasurer, and such other officers as the NSX Board may determine.<sup>91</sup> Any two or more offices may be held by the same person, except that the Chief Regulatory Officer and the Secretary may not be the CEO or the President.<sup>92</sup> The Chairman of the NSX Board, subject to approval of the NSX Board, may designate one or more officers or other employees of NSX to serve as an Arbitration Director, who would perform or delegate all ministerial duties in connection with matters submitted for arbitration pursuant to the rules of NSX.<sup>93</sup>

(vi) Self-Regulatory Function and Oversight

As noted above, following the demutualization NSX would continue to be registered as a national securities exchange under Section 6 of the Act and thus would continue to be an SRO.<sup>94</sup> The Exchange states that, as an SRO, NSX would be obligated to carry out its statutory responsibilities, including enforcing compliance by ETP Holders with the provisions of the

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<sup>89</sup> See proposed NSX By-Laws, Section 5.6.

<sup>90</sup> See Securities Exchange Act Release No. 34-52573 (October 7, 2005), 70 FR 60113 (October 14, 2005) (File No. SR-NSX-2005-07).

<sup>91</sup> See proposed NSX By-Laws, Section 6.1. Under the current By-Laws of NSX, the officers of NSX are a Chairman of the Board, President, Secretary, Treasurer, and such other officers as may be appointed by the Board of Directors of NSX.

<sup>92</sup> See proposed NSX By-Laws, Section 6.1. Under the current By-Laws of NSX, the Secretary may not hold either the office of Chairman of the Board or President.

<sup>93</sup> See proposed NSX By-Laws, Section 6.6. NSX states that this provision is consistent with the current By-Laws of NSX.

<sup>94</sup> See 15 U.S.C. 78c(a)(26).

federal securities laws and the applicable rules of NSX. Further, NSX states that it would retain the responsibility to administer and enforce the rules that govern NSX and the activities of its ETP Holders. In addition, NSX states that it would continue to be required to file with the Commission, pursuant to Section 19(b) of the Act<sup>95</sup> and Rule 19b-4 thereunder,<sup>96</sup> any changes to its rules and governing documents. The Exchange states that the structural protections adopted by NSX pursuant to the Order to ensure that NSX's regulatory functions are independent from the commercial interests of NSX and its members would remain in effect following demutualization.

NSX states that, like the proposed Holdings By-Laws, the proposed NSX By-Laws contain specific provisions relating to the self-regulatory function of NSX.<sup>97</sup> For example, the proposed NSX By-Laws require the NSX Board to consider applicable requirements under Section 6(b) of the Act in connection with the management of the Exchange.<sup>98</sup> In addition, meetings of the NSX Board and of the committees of NSX that pertain to the self-regulatory function of NSX must be closed to persons who are not members of the NSX Board or NSX officers, staff, counsel, or other advisors whose participation is necessary or appropriate to the

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<sup>95</sup> 15 U.S.C. 78s(b).

<sup>96</sup> 17 CFR 240.19b-4.

<sup>97</sup> See proposed NSX By-Laws, Article X.

<sup>98</sup> See proposed NSX By-Laws, Section 10.1. Section 6(b) of the Act requires, among other things, that the Exchange's rules be designed to protect investors and the public interest. It also requires that the Exchange be so organized that it has the capacity to carry out the purposes of the Act and to enforce compliance by its members with the Act, the rules and regulations promulgated thereunder, and the rules of the Exchange.

self-regulatory function of NSX, or representatives of the Commission.<sup>99</sup>

Further, the NSX books and records reflecting confidential information relating to the self-regulatory function of NSX must be kept confidential, must not be used for non-regulatory purposes, and must not be made available to any person other than those directors, officers, and agents of NSX to the extent necessary or appropriate to properly discharge NSX's self-regulatory responsibilities, and the books and records of NSX must be maintained in the U.S.<sup>100</sup> The proposed NSX By-Laws also provide that any revenues received by NSX from fees derived from its regulatory function or regulatory penalties must be applied to fund the legal and regulatory operations of NSX or to pay restitution and disgorgement of funds intended for NSX customers, and may not be used to pay dividends.<sup>101</sup>

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<sup>99</sup> See proposed NSX By-Laws, Section 10.2. In addition, the Exchange states that members of the Holdings Board who are also not members of the NSX Board and any officers, staff, counsel, or advisors of Holdings who do not hold similar positions with respect to NSX would not be allowed to participate in any meeting of the NSX Board (or any committee of NSX) that pertains to the self-regulatory function of NSX. NSX states that these requirements and the requirements relating to the confidentiality of records are not, however, designed to prevent the Exchange from sharing with Holdings the type of information about the Exchange's business that would ordinarily be shared with a parent corporation, including information relating to the Exchange's compliance with applicable laws, reports from the Commission or others evaluating the Exchange's self-regulatory programs, and information about the trading activities and business strategies of the Exchange's ETP Holders.

<sup>100</sup> See proposed NSX By-Laws, Sections 10.3.

<sup>101</sup> See proposed NSX By-Laws, Section 10.4.

(vii) Restrictions on ownership and transfer

Although there are no percentage-based restrictions on the ownership of NSX, the proposed NSX Certificate of Incorporation confirms that Holdings will own all of the voting stock of NSX at all times.<sup>102</sup>

(viii) Changes to Certificate of Incorporation and By-Laws

Under the proposed NSX Certificate of Incorporation, any change to that document must first be approved by the NSX Board and, if required to be approved or filed with the Commission before it may become effective, cannot take effect until the procedures of the Commission necessary to make it effective have been satisfied.<sup>103</sup>

Similarly, under the proposed NSX By-Laws, any change to that document that is required to be approved by or filed with the Commission before it may become effective cannot take effect until the procedures of the Commission necessary to make it effective have been satisfied.<sup>104</sup> Changes to the NSX By-Laws as proposed may be made by either the stockholders of NSX or the NSX Board, except that certain provisions relating to the NSX Board, and to the voting of NSX stockholders may not be changed without the approval of the stockholder of NSX.<sup>105</sup>

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<sup>102</sup> See proposed NSX Certificate of Incorporation, Article Fourth. Under the current By-Laws of NSX, certificates of proprietary membership may be sold to a person whose application for proprietary membership in NSX has been approved by NSX only if the owner of the certificate has paid in full all obligations to the Exchange and certain claims of creditors who are members of the Exchange. In addition, a registered national securities exchange may purchase, hold or sell certificates of proprietary membership only with approval of the Board of Directors of NSX.

<sup>103</sup> See proposed NSX Certificate of Incorporation, Article Eleventh.

<sup>104</sup> See proposed NSX Certificate of Incorporation, Article Seventh.

<sup>105</sup> See proposed NSX Certificate of Incorporation, Article Seventh and proposed NSX By-Laws, Section 8.1. Under the current By-Laws of NSX, changes to the By-Laws may be

(c) Other Provisions in the Certificates of Incorporation and By-Laws

The proposed Holdings By-Laws, Holdings Certificate of Incorporation, NSX Certificate of Incorporation, and NSX By-Laws contain other customary provisions of for-profit corporations, such as provisions relating to corporate offices and corporate purposes;<sup>106</sup> director meetings, voting, removal, compensation and limitation of liability;<sup>107</sup> indemnification of, and insurance for, directors, officers, employees and agents, and advancement of expenses related to defending certain actions;<sup>108</sup> stock certificate procedures;<sup>109</sup> stockholder ownership, including provisions relating to the timing and conduct of meetings, record dates, quorum requirements, proxies, and other matters;<sup>110</sup> and other general provisions.<sup>111</sup> These provisions are designed to reflect current and customary corporate practices.

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proposed by any member of the Board of Directors of NSX by resolution or 1/3<sup>rd</sup> of the proprietary members by petition. The NSX Board then determines whether to approve submission of the proposed change to the proprietary members for their approval. In addition, consistent with the current By-Laws of NSX, Sections 3.1(b) and 8.2 of the proposed NSX By-Laws permit the NSX Board to amend, repeal, and adopt new Rules of the Exchange.

<sup>106</sup> See proposed NSX Certificate of Incorporation, Articles Second and Third, and proposed NSX By-Laws, Article II; see proposed Holdings Certificate of Incorporation, Articles Second and Third, and proposed Holdings By-Laws, Article I.

<sup>107</sup> See proposed NSX Certificate of Incorporation, Articles Fifth and Eighth, and proposed NSX By-Laws, Article III and Section 7.1; see proposed Holdings Certificate of Incorporation, Articles Sixth and Ninth, and proposed Holdings By-Laws, Article II and Section 7.1.

<sup>108</sup> See proposed NSX By-Laws, Article VII, and proposed Holdings By-Laws, Article VII. In addition, under these provisions, neither corporation is liable for any loss or damage sustained by a current or former member of NSX or ETP Holder relating to such person's use of the facilities of the Exchange or its subsidiaries.

<sup>109</sup> See proposed NSX By-Laws, Article IX, and proposed Holdings By-Laws, Article IX.

<sup>110</sup> See proposed NSX Certificate of Incorporation, Article Ninth, and proposed NSX By-Laws, Article IV; See proposed Holdings Certificate of Incorporation, Article Tenth, and proposed Holdings By-Laws, Article IV.

(2) National Market System Plans

NSX currently is a participant in various National Market System (“NMS”) plans, including, but not limited to, the Consolidated Tape Association Plan, the Consolidated Quotation System Plan, the Intermarket Trading System Plan, the Intermarket Surveillance Group, and the Reporting Plan for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis (“Nasdaq UTP”) Plan. These plans are joint industry plans entered into by SROs for the purpose of addressing last sale reporting, quotation reporting, and intermarket equities trading. Following the completion of the demutualization, NSX, in its continuing role as the SRO, would continue to serve as the voting member of these NMS plans, and a representative of NSX would continue to serve as the Exchange’s representative with respect to dealing with these plans.

(3) Equity Trading Permits; Administrative Changes

The proposed rule change includes proposed changes to the Rules of the Exchange that are necessary to implement the proposed ETP structure. As noted above, following NSX’s demutualization, persons and firms who have been qualified for membership pursuant to the Exchange’s current Rules and By-Laws and, as a result, have access to the Exchange’s trading facilities would receive ETPs entitling them to maintain their trading access to NSX and would be referred to as ETP Holders. The Exchange proposes to replace references to “members,” “member organizations,” and similar terms in the current Rules of the Exchange with references to “ETP Holders” and similar terms in the NSX Rules.

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<sup>111</sup> See, for example, proposed NSX Certificate of Incorporation, Article Tenth, and proposed NSX By-Laws, Article XI; See, e.g., proposed Holdings Certificate of Incorporation, Article Eleventh, and proposed Holdings By-Laws, Article X.

The Exchange states that each ETP would constitute a revocable license allowing the holder of the permit access to the Exchange’s trading facilities in the same manner as previously authorized for NSX’s qualified trading members.<sup>112</sup> The demutualization and the implementation of the use of ETPs would not change current NSX member access to the Exchange or their ability to execute transactions. NSX states that persons holding ETPs of NSX would be “members” of the Exchange for purposes of the Act and, as noted above, will be characterized as ETP Holders subject to NSX’s regulatory jurisdiction.<sup>113</sup> ETP Holders would not have any ownership interest in NSX or in Holdings by virtue of their ETPs.

NSX proposes to move the provisions of the current By-Laws of NSX relating to members to a single chapter in the NSX Rules regarding ETP Holders, with certain changes based upon the fact that ETP Holders would be subject to modestly different application processes and would not have to purchase and own a certificate of proprietary membership.<sup>114</sup>

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<sup>112</sup> See proposed NSX Rules, Chapter II, Rules 2.1 and 2.2, and proposed NSX Rules, Chapter I, Rule 1.5 (definition of “ETP”).

<sup>113</sup> See proposed NSX Rules, Chapter I, Rule 1.5 (definition of “ETP Holder”).

<sup>114</sup> NSX states that, currently, applicants for membership are required to purchase and own a certificate of proprietary membership in order to become a member of NSX. See Article II, Section 5.2 of the current By-Laws of NSX. NSX states that all outstanding certificates of proprietary membership would be cancelled in connection with the demutualization, and no other certificates of proprietary membership would be issued by NSX following the demutualization.

Following the demutualization, the Exchange states that it would require persons seeking ETPs to complete appropriate application materials and registration forms, satisfy regulatory requirements, and pay processing charges and application fees as designated by the Exchange. NSX states that this process of applying for an ETP immediately following demutualization would be substantially similar to the current membership application process, except that ETP Holders would not be required to be approved by NSX's Membership Committee, ETP Holders would be subject to the financial responsibility requirements of Rule 15c3-1 under the Act (but would not be subject to a separate net capital requirement), and ETP applicants would not need to purchase shares of either NSX or Holdings.<sup>115</sup>

The Exchange states that, once issued, an ETP would be effective until voluntarily terminated by the ETP Holder or until revoked by NSX for, among other things, noncompliance with the NSX Rules.<sup>116</sup> NSX would have the ability to revoke an ETP for the same reasons that it is currently entitled to revoke a membership.<sup>117</sup> An ETP could not be sold, leased, or otherwise transferred.<sup>118</sup> There would be nominal processing charges and application fees relating to the issuance of ETPs. In addition, ETP Holders would be subject to such fees as are designated by NSX or set forth in the NSX Rules.<sup>119</sup>

NSX also proposes to move certain other provisions of the current By-Laws of NSX respecting listing standards and other matters not relating to the Exchange's corporate

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<sup>115</sup> See proposed NSX Rules, Chapter II. The Exchange states that applicants for membership currently must purchase and own a certificate of proprietary membership of NSX in order to become an NSX member.

<sup>116</sup> See proposed NSX Rules, Chapter II, Rules 2.6 and 2.7.

<sup>117</sup> See proposed NSX Rules, Chapter II, Rule 2.6.

<sup>118</sup> See proposed NSX Rules, Chapter II, Rule 2.8.

governance to the NSX Rules. For example, the Exchange proposes to move the provisions contained in Article IV of the current By-Laws of NSX (relating to Securities Listed on the Exchange) to a new Chapter XV of the NSX Rules. NSX also proposes to move Rules 13.6 and 13.7 (relating to Listing Standards) to this new Chapter XV of the NSX Rules.<sup>120</sup>

Finally, NSX proposes to include a new Rule 2.10 that would prohibit, without prior Commission approval, either (i) NSX or any NSX affiliate from directly or indirectly acquiring or maintaining an ownership interest in an ETP Holder, or (ii) an ETP Holder being or becoming an affiliate of NSX or any affiliate of NSX. Under proposed Rule 2.10 the term “affiliate” has the meaning specified in Rule 12b-2 of the Act. Proposed Rule 2.10 would not prohibit any ETP Holder or its affiliate from acquiring or holding an equity interest in Holdings that is permitted by the ownership and voting limitations in the Holdings Certificate of Incorporation, and would not prohibit an ETP Holder or an officer, director, manager, managing member, partner, or affiliate of an ETP Holder being or becoming an ETP Holder Director or an At-Large Director on the NSX Board, or a member of the Holdings Board.<sup>121</sup>

## 2. Statutory Basis

NSX believes the proposal, as amended, is consistent with the requirements of the Act and the rules and regulations promulgated thereunder that are applicable to a national securities

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<sup>119</sup> See, generally NSX Rules, Chapter XI, Rule 11.10(B).

<sup>120</sup> In addition, NSX also proposes to move to the NSX Rules, and make technical changes to, certain provisions under the current By-Laws of NSX relating to Exchange Membership (Article II), Dues, Assessments and Other Charges (Article III), Securities Listed on the Exchange (Article IV), Commissions (Article XI) and Off-Exchange Transactions (Article XII).

<sup>121</sup> See Amendment No. 1, supra note 3.

exchange, and in particular, with Section 6(b) of the Act.<sup>122</sup> NSX believes that the proposal, as amended, is consistent with Section 6(b)(5) of the Act<sup>123</sup> in that it would create a governance and regulatory structure of the Exchange that is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange states that it remains committed to its role as a national securities exchange and does not believe that the proposed change to a for-profit institution will undermine its responsibilities for regulating its marketplace. Indeed, as described above, the Exchange believes that it has proposed specific provisions in the proposed Holdings By-Laws and the proposed NSX By-Laws that reinforce the ability of the Exchange to perform its self-regulatory functions.

Moreover, the Exchange states that it is not proposing any significant changes to its existing operational and trading structure in connection with the demutualization. Instead, NSX represents that the proposed rule change, as amended, primarily consists of: organizational changes to the NSX Articles of Incorporation and By-Laws reflecting the changes in governance and corporate form; and rule changes that are necessary to implement the new NSX ETP structure, which would replace the existing structure of Exchange memberships as a basis for trading rights. The Exchange believes that the proposed rule change is consistent with governance changes approved by the Commission for other demutualized exchanges and does not serve to erode the principles articulated in the Commission's recent governance release.<sup>124</sup>

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<sup>122</sup> 15 U.S.C. 78f(b).

<sup>123</sup> 15 U.S.C. 78f(b)(5).

<sup>124</sup> See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) (File No. S7-39-04).

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes the proposed rule change, as amended, will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were solicited or received by the Exchange on this proposal, as amended.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

- A. by order approve the proposed rule change, as amended, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSX-2006-03 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NSX-2006-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-NSX-2006-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>125</sup>

Nancy M. Morris  
Secretary

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<sup>125</sup> 17 CFR 200.30-3(a)(12).