

# **CHARLES & COLVARD, LTD.**

(as adopted by the Board of Directors on February 16, 2004  
and as amended on March 10, 2004)

## **Corporate Governance Guidelines**

### **I. Introduction**

Acting on the recommendation of its Nominating and Governance Committee, the Board of Directors of Charles & Colvard, Ltd. (the “Company”) has adopted these Corporate Governance Guidelines to promote the effective functioning of the Board and its committees and to ensure a common understanding among individual directors and management concerning the operation of the Board and its various committees. The Board may modify these Guidelines from time to time upon the recommendation of the Nominating and Governance Committee.

### **II. Board Composition and Size**

The members of the Board should collectively possess a broad range of skills, industry and other knowledge and expertise, and business and other experience useful for the effective oversight of the Company’s business. A majority of the Board will consist of directors who the Board has determined are “independent” under the requirements of the Securities and Exchange Commission and the Nasdaq Stock Market, Inc. (an “Independent Director”).

It is the sense of the Board that, absent special circumstances, the Board should consist of no fewer than five (5) and no more than nine (9) members.

### **III. Selection of Chairman of the Board and Chief Executive Officer**

The Board will select its Chairman and the Chief Executive Officer (the “CEO”) to promote the best interests of the Company.

### **IV. Selection of Directors**

**A. *Nominations and Appointments.*** The Board’s Nominating and Governance Committee will be responsible for identifying and recommending to the Board qualified candidates for Board membership, based primarily on the following criteria:

1. Judgment, character, expertise, skills and knowledge useful to the oversight of the Company’s business;
2. Diversity of viewpoints, backgrounds, experiences and other demographics;
3. Business or other relevant experience; and

4. The extent to which the interplay of the candidate's expertise, skills, knowledge and experience with that of other Board members will build a Board that is effective, collegial and responsive to the needs of the Company.

The Nominating and Governance Committee will evaluate suggestions concerning possible candidates for election to the Board submitted to the Company, including those submitted by Board members, shareholders and third parties. The CEO will provide the Nominating and Governance Committee with a copy of any notification received by the Company from a shareholder purporting to nominate a candidate for election as a director pursuant to Article II, Section 6, of the Company's bylaws.

The Board, taking into consideration the recommendations of the Nominating and Governance Committee, will be responsible for selecting the nominees for election to the Board by the shareholders and for appointing directors to the Board to fill vacancies, with primary emphasis on the criteria set forth above. The Board, taking into consideration the assessment of the Nominating and Governance Committee, will also make a determination as to whether a nominee or appointee would be an Independent Director.

**B. *Invitations.*** The invitation to join the Board will be extended by the Board via the Chairman unless he or she designates another director to extend the invitation.

## **V. Continuation as a Director**

**A. *Review of Continuation Based on Age.*** Upon attaining the age of 70 and annually thereafter, a director will tender a letter of proposed retirement from the Board to the Chairperson of the Nominating and Governance Committee. The Nominating and Governance Committee will review the director's continuation on the Board, and recommend to the Board whether, in light of all the circumstances, the Board should accept such proposed retirement or request that the director continue to serve.

**B. *Resignation of Chairman or CEO.*** A Chairman or CEO who resigns from that position will tender to the Board a letter of proposed resignation from the Board. The Nominating and Governance Committee will review the director's continuation on the Board, and recommend to the Board whether, in light of all the circumstances, the Board should accept such proposed resignation or request that the director continue to serve.

**C. *Change In Job Responsibility.*** When a director's principal occupation or business association changes substantially from the position he or she held when originally invited to join the Board, the director will tender a letter of proposed resignation from the Board to the Chairperson of the Nominating and Governance Committee. The Nominating and Governance Committee will review the director's continuation on the Board, and recommend to the Board whether, in light of all the circumstances, the Board should accept such proposed resignation or request that the director continue to serve.

**D. *No Term Limits.*** The Board believes that consistent quality in membership of the Board can best be achieved without term limits on the service of directors.

## **VI. The Committees of the Board**

The Board will have at least three committees: the Audit Committee; the Compensation Committee; and the Nominating and Governance Committee (the “Committees”). Each Committee will have a written charter. The Board expects to accomplish a substantial amount of its work through the Committees. Each Committee will report regularly to the Board summarizing the Committee’s actions and any significant issues considered by the Committee.

Each of the Audit Committee, the Compensation Committee and the Nominating and Governance Committee will be composed of no fewer than three members. Each Committee member must satisfy the membership requirements set forth in the relevant Committee charter. A director may serve on more than one Committee.

The Board will be responsible for identifying directors qualified to fill vacancies on any Committee. The Board, taking into account the views of the Chairman, will designate one member of each Committee as Chairperson of such Committee. It is the sense of the Board and the Nominating and Governance Committee that consideration should be given to rotating members of the Committees periodically in the event the size of the Board justifies committees consisting of fewer than all independent directors, but they do not believe that such a rotation should be mandated as a policy because there may be reasons at a given point in time to maintain an individual director’s committee membership.

## **VII. Board and Committee Meetings**

The Board will have at least four (4) full agenda meetings each year at which all members participate in person absent special circumstances. Further meetings will occur if called in accordance with the Company’s bylaws. The Board may act via telephone or video conference and by unanimous written consent in lieu of a meeting when necessary.

Each Committee will have the number of meetings provided for in its charter, with further meetings to occur (or action to be taken by unanimous written consent) when deemed necessary and called in accordance with the Committee’s charter.

The agenda for each Board meeting will be established by the Chairman and CEO. Any Board member may suggest the inclusion of additional subjects on the agenda. The agenda for each Committee meeting will be established by the Committee Chairperson in consultation with appropriate members of the Committee and with management. Management will seek to provide appropriate materials in advance of Board and Committee meetings, except when not consistent with the timing of matters to be considered and the operations of the business, or otherwise when it may not be possible to circulate materials in advance of the meeting. In cases where materials are not circulated by management in advance of a meeting, such materials will be distributed in paper form to the Board and Committee members at the meeting prior to the actual presentation of the matter covered by the materials. Materials presented to the Board and Committee

members should provide the information needed for the directors to make an informed judgment or engage in informed discussion.

At least annually, the Chairman and CEO will issue to the other Board members a schedule of the foreseeable primary agenda subjects intended to be discussed by the Board and the proposed meeting dates for the next year, and each Committee's Chairperson will issue to the other Committee members a schedule of the foreseeable primary agenda subjects intended to be discussed by the Committee and the proposed meeting dates for the next year.

Unless a Committee elects to meet in executive session as contemplated by Article VIII or expressly determines otherwise, the agenda, materials and minutes for each Committee meeting will be available to all directors, and all directors will be free to attend any Committee meeting unless to do so would conflict with the Committee's charter or applicable rules of the Nasdaq Stock Market, Inc. or the Securities and Exchange Commission. In addition, all directors, whether or not members of the Committee, will be free to make suggestions to a Committee Chairperson for additions to the agenda of his or her Committee or to request that an item from a Committee agenda be considered by the Board.

#### **VIII. Executive Sessions**

To ensure free and open discussion and communication among the non-management directors, these directors will meet in executive session at all regularly scheduled meetings of the Board with no members of management present. The Chairperson of the Nominating and Governance Committee or the Chairman of the Board will preside at the executive sessions, unless the non-management directors determine otherwise. In addition, any Committee of the Board may hold an executive session with any directors who are not members of such Committee attending only by invitation.

#### **IX. Board Responsibilities**

The business and affairs of the Company are managed by or under the direction of the Board in accordance with the North Carolina Business Corporation Act. The Board's responsibility is to provide direction and oversight. The Board establishes the strategic direction of the Company and oversees the performance of the Company's business and management. The management of the Company is responsible for presenting strategic plans to the Board for review and approval and for implementing the Company's strategic direction. In performing their duties, the primary responsibility of the directors is to exercise their business judgment in the best interests of the Company.

Certain specific corporate governance functions of the Board are set forth below:

**A. Management Succession.** The Board, acting through the Compensation Committee, will review and concur on a management succession plan, developed by the CEO, to ensure a continuity in senior management. This plan, on which the CEO will report at least annually, will address:

1. emergency CEO succession;
2. CEO succession in the ordinary course of business; and
3. succession for the other members of senior management. The plan will include an assessment of senior management experience, performance, skills and planned career paths.

**B. Evaluating the CEO.** The Board, acting through the Compensation Committee, will annually conduct an evaluation of the performance of the CEO based on such personal and Company performance criteria as it determines to be appropriate. The results of this evaluation will be provided to the CEO and to the full Board.

**C. Director Compensation.** The Compensation Committee will periodically review the form and amounts of director compensation and make recommendations to the Board concerning these matters. The Board will set the form and amounts of director compensation, taking into account the recommendations of the Compensation Committee. The Board believes that the amount of director compensation should fairly reflect the contributions of the directors to the performance of the Company. Management will at least annually prepare and provide to the Chairperson of the Compensation Committee a report on the director compensation policies and practices of comparable companies. Only non-management directors will receive compensation for services as a director. To create a direct linkage of compensation with corporate performance, the Board believes that a meaningful portion of the total compensation of non-management directors should be provided and held in common stock, stock options, restricted stock units or other types of equity-based compensation.

**D. Reviewing and Approving Significant Matters.** Board approval of a particular transaction, plan, policy, strategy or other significant matter may be appropriate because of several factors, including:

1. legal, governance or regulatory requirements;
2. the materiality of the matter to the Company's financial performance, risk profile or business;
3. the terms of the transaction, plan, policy, strategy or other significant matter; or
4. other factors, such as the entering into of a new strategic line of business or a variation from the Company's strategic plan.

To the extent the Board determines it to be appropriate, the Board will develop standards to be utilized by management in determining types of matters that should be submitted to the Board for review and approval or notification.

## **X. Expectations for Directors**

The Board has developed a number of specific expectations of directors to promote the discharge by the directors of their responsibilities and to promote the efficient conduct of the Board's business. It is understood that the non-management directors are not full-time employees of the Company.

**A. Commitment and Attendance.** All directors should make every effort to attend meetings of the Board and the Committees of which they are members. Attendance by telephone or video conference may be used to facilitate a director's attendance when necessary.

**B. Participation in Meetings.** Each director should be sufficiently familiar with the business of the Company, including its financial statements and capital structure, and the risks and the competition it faces, to ensure active and effective participation in the deliberations of the Board and of each Committee on which he or she serves. Upon request, management will make appropriate Company employees available to answer any questions a director may have about any aspect of the Company's business. Directors should also review the materials provided by management and advisors in advance of the meetings of the Board and its Committees and should arrive prepared to discuss the issues presented.

**C. Loyalty and Ethics.** In their roles as directors, all directors owe a duty of loyalty to the Company. This duty of loyalty mandates that the best interests of the Company take precedence over any interest possessed by a director. The Company's Nominating and Governance Committee will periodically recommend to the Board, and the Board will consider, any revisions to the Company's Code of Business Conduct and Ethics which may be appropriate. Certain portions of the Code will deal with activities of directors, particularly with respect to potential conflicts of interest, the taking of corporate opportunities for personal use and transactions in the securities of the Company. Directors should be familiar with the Code's provisions in these areas and should consult with the Company's (or his or her own) legal counsel as appropriate.

**D. Other Directorships and Significant Activities.** The Company values the experience directors bring from other boards on which they serve and other activities in which they participate, but recognizes that those boards and activities may also present demands on a director's time and availability and may present conflicts or legal issues, including independence issues. Directors should advise the Chairperson of the Nominating and Governance Committee and the CEO before accepting membership on other boards of directors or any audit committee or other significant committee assignment on any other board of directors, or establishing other significant business, government or civic relationships, particularly those that may result in significant time commitments or a change in the director's relationship to the Company.

**E. Contact with Management and Employees.** All directors will be free to contact the CEO at any time to discuss any aspect of the Company's business. Directors will also have complete access to other employees of the Company. The Board expects that there will be frequent opportunities for directors to meet with the CEO and other members of management in Board and Committee meetings, or in other formal or informal settings.

Further, the Board encourages management to bring into Board meetings from time to time (or otherwise make available to Board members) individuals who can provide additional insight into the items being discussed because of personal involvement and substantial knowledge in those areas.

**F. Speaking on Behalf of the Company.** It is important that the Company speak to shareholders, employees and outside constituencies with a single voice, and that management serve as the primary spokesperson. If a situation does arise in which it seems necessary for a non-management director to speak on behalf of the Company to one of these constituencies, the director should listen to the concerns or questions presented and, in order to assure compliance with applicable legal requirements and Company policies, consult with management and the Company's legal counsel regarding appropriate responses.

**G. Confidentiality.** The proceedings and deliberations of the Board and its Committees will be confidential. Each director will maintain the confidentiality of information received in connection with his or her service as a director, except as otherwise required by law.

## **XI. Policy Regarding Shareholder Communication With Directors**

It is the policy of the Company and its Board to encourage free and open communication between shareholders and the Board. Any shareholder wishing to communicate with the Board should send any communication to Corporate Secretary, Charles & Colvard, Ltd., 3800 Gateway Boulevard, Suite 310, Morrisville, North Carolina 27560. Any such communication must be in writing, and must state the number of shares beneficially owned by the stockholder making the communication. The Corporate Secretary will forward such communication to the full Board or to any individual director or directors to whom the communication is directed unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case the Corporate Secretary has the authority to discard the communication or take appropriate legal action regarding the communication.

This policy is not designed to preclude other communications between the Board and shareholders on an informal basis. However, in all cases Directors should understand and follow the specific Expectations of Directors listed above, in particular the expectation concerning Speaking on Behalf of the Company.

## **XII. Evaluating Board and Committee Performance**

The Board, acting through the Nominating and Governance Committee, will conduct periodic self-evaluations and evaluations of the Committees.

## **XIII. Orientation and Continuing Education**

Management, working with the Board, will provide an orientation process for new directors, including background material on the Company and its business. As appropriate, management will prepare additional educational sessions for directors on matters relevant to the Company and its business.

#### **XIV. Reliance on Management and Outside Advice**

In performing its functions the Board will be entitled to rely on the advice, reports and opinions of management, counsel, accountants, auditors and other expert advisors. Except as otherwise provided in a charter of a Committee, the Board will have the authority to select, retain, terminate and approve the fees and other retention terms of its outside advisors.