



Client Alert



Contact Attorney Regarding
This Matter:

Joseph Alley, Jr.
404.873.8688 - direct
joseph.alley@agg.com

Tanner D. Ivie
404.873.8788 - direct
tanner.ivie@agg.com

Arnall Golden Gregory LLP
Attorneys at Law

171 17th Street NW
Suite 2100
Atlanta, GA 30363-1031

1 Biscayne Tower
Suite 2690
2 South Biscayne Boulevard
Miami, FL 33131

2001 Pennsylvania Avenue NW
Suite 250
Washington DC 20006

www.agg.com

NYSE and Nasdaq Propose Changes to Compensation Committee Listing Standards

Background

Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") added Section 10C to the Securities Exchange Act of 1934. Section 10C requires the Securities and Exchange Commission (the "SEC") to adopt rules directing the national securities exchanges and associations to prohibit the listing of any equity security of an issuer that does not comply with Section 10C's compensation committee and compensation adviser requirements. Accordingly, on June 20, 2012, the SEC adopted new Rule 10C-1, which directs the national securities exchanges to adopt listing rules that comply with Section 10C.

On September 25, 2012, the New York Stock Exchange LLC ("NYSE") and the NASDAQ Stock Market LLC ("Nasdaq") unveiled proposed changes to their listing rules to comply with the mandates of Section 10C and Rule 10C-1. The NYSE amended its proposal on October 1, 2012 to clarify the proposal's implementation deadlines.

Compensation Committee Member Independence

NYSE. Compensation committee members will still be required to be independent under the NYSE's general board independence standards set forth in Section 303A.02, including the five bright-line tests under subsection (b). The NYSE has not proposed any changes to these general standards. Instead, the NYSE's proposed Section 303A.02(a)(ii) requires that in determining a compensation committee member's independence, the board must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to, the two factors enumerated in Rule 10C-1(b)(ii). These two factors are: (1) the source of compensation of such director, including any consulting, advisory or other compensatory fee paid by the listing company to such director; and (2) whether such director is affiliated with the listed company, a subsidiary of the listed company or an affiliate of a subsidiary of the listed company.

Importantly, the NYSE does not propose to adopt specific numerical or bright-line tests or require consideration of other specific factors. The NYSE declined to apply the independence standards applicable to audit committee members to compensation committee members, but rather opted for a more principles-based approach. As a result, receipt of any consulting, advisory or other compensatory fee is not a per se disqualification for compensation committee members, but merely a factor that must be considered by the board in

determining independence. Similarly, affiliation with the issuer is likewise not a per se disqualification but must be evaluated on a qualitative basis.

As a result, the board should consider whether the director receives compensation from any person or entity that would impair his ability to make independent judgments about the listed company's executive compensation. Similarly, the board should consider whether an affiliate relationship places the director under the direct or indirect control of the listed company or its senior management, or creates a direct relationship between the director and members of senior management, in each case of a nature that would impair his ability to make independent judgments about the listed company's executive compensation.

Nasdaq. Nasdaq also requires compensation committees to be comprised solely of independent directors, as defined under the two-part test in Rule 5605(a)(2). Yet, unlike the NYSE, Nasdaq proposes to adopt the same independence standard for compensation committee members, with respect to compensatory fees, which currently applies to audit committee members. Specifically, Nasdaq's proposal prohibits a compensation committee member from accepting directly or indirectly any consulting, advisory or other compensatory fee, other than for board service, from an issuer or any subsidiary. The prohibition begins with the member's term of service on the committee.

Nasdaq, however, declined to incorporate the prohibition that applies to affiliates serving on audit committees into its standard for compensation committee members. As did the NYSE, Nasdaq concluded that it may be appropriate for certain affiliates to serve on compensation committees since their interests align with other stockholders seeking an appropriate executive compensation program. Accordingly, a board should consider affiliation in making an eligibility determination, but Nasdaq does not otherwise propose bright-line rules with respect to this affiliation factor. Affiliation is only considered with respect to relationships that occur during a member's term of service.

Nasdaq does propose, however, to retain its existing exception that allows a company to have a non-independent director serve on the compensation committee under exceptional and limited circumstances.

Compensation Committee Advisers

NYSE. The NYSE proposes to adopt the requirements specified in Rule 10C-1(b)(2) and (3) verbatim as new Section 303A.05(c) with respect to the required powers of the compensation committee. As a result, the proposed subsection (c) requires that compensation committees have: (i) discretionary authority to retain or obtain the advice of compensation advisers; (ii) direct responsibility for the appointment, compensation and oversight of the compensation advisers; and (iii) authority to appropriate funding from the listed company to pay reasonable compensation to their advisers. These mandated powers are in significant part currently required by the NYSE's existing compensation committee listing standard, as they are required elements of the compensation committee charter as set forth in Section 303A.05(b). In the interest of clarity and emphasis, the NYSE is proposing to delete the current provisions of Section 303A.05(b) that are duplicative of proposed new Section 303A.05(c). A listed company's charter must provide that the compensation committee has all of the powers specified in new subsection (c).

In addition, proposed subsection (c)(iv) specifies that, before engaging an adviser other than in-house legal counsel, the compensation committee must consider the six independence factors articulated in Rule 10C-1(b)(4). These six factors are:

1. The provision of other services to the listed company by the adviser's employer;
2. The amount of fees received from the listed company by the adviser's employer, as a percentage of the total revenue of the adviser's employer;
3. The policies and procedures of the adviser's employer that are designed to prevent conflicts of interest;
4. Any business or personal relationship of the adviser with a member of the compensation committee;
5. Any stock of the listed company owned by the adviser;
6. Any business or personal relationship of the adviser or the adviser's employer with an executive officer of the listed company.

Notably, the requirement that these factors be considered will apply to consultation with the listed company's outside legal counsel as well as to consultation with any compensation consultant. The NYSE declined to include any additional factors for consideration, but the proposed standard would require the committee to consider any other factors that would be relevant to the adviser's independence from management. The NYSE proposes an explicit statement that nothing in subsection (c) shall be construed: (A) to require the compensation committee to implement or act consistently with the advice or recommendations of the adviser; or (B) to affect the ability or obligation of the compensation committee to exercise its own judgment in fulfillment of its duties. A finding that an adviser is not independent would not prohibit the compensation committee from consulting with him or her; however, the SEC's recent revisions to Item 407(e) of Regulation S-K, effective for annual meetings occurring after January 1, 2013, would require disclosure of the nature of any conflicts of interest with respect to compensation consultants, as opposed to legal advisers, and how the conflicts were being addressed.

Nasdaq. Nasdaq's proposed Listing Rule 5605(d)(3) states that the compensation committee must have the specific responsibilities and authority necessary to comply with Rule 10C-1(b)(2), (3) and (4)(i)-(iv) relating to the authority to retain and fund compensation advisers and the responsibility to consider independence factors when selecting the advisers. Furthermore, the compensation committee charter would have to specify the aforementioned responsibilities and authority. As did the NYSE, Nasdaq declined to propose any additional independence factors, other than the six factors in Rule 10C-1, for consideration when selecting an adviser. Nasdaq emphasized that the compensation committee is not required to retain an independent compensation adviser; the committee is only required to undertake the independence analysis before selecting a compensation adviser.

Nasdaq Compensation Committee Requirement

Nasdaq proposes to eliminate its current rule allowing executive compensation to be determined by independent directors constituting a majority of the board's independent directors in a vote in which only independent directors participate. Instead, Nasdaq-listed companies would now be required to have a standing compensation committee consisting of at least two members of the board of directors, and each such compensation committee would be required to have its own written charter, which must comply with Nasdaq's proposed new standards. In addition to addressing the scope of the committee's responsibilities, these standards include a prohibition on the CEO being present during voting or deliberations by the compensation committee on his or her compensation.

Cure Periods

NYSE. The NYSE's proposal adopts the cure provision period in Rule 10C-1(a)(3), which states that if a compensation committee member ceases to be independent for reasons outside the member's reasonable control, that person, with notice by the issuer to the relevant exchange or securities association, may remain a compensation committee member until the earlier of the next annual meeting or one year from the occurrence of the event that caused the member to no longer be independent. The NYSE, however, would limit the cure provision to circumstances where the committee continues to have a majority of independent directors.

Nasdaq. Nasdaq's proposed cure provision similarly provides that if the listed company fails to comply with the compensation committee composition requirement due to one vacancy or one compensation committee member ceases to be independent for reasons outside the member's control, then the company will have until the earlier of the next annual meeting or one year from the event that caused the failure in compliance; provided, however, in order to avoid the possibility of an unreasonably short time frame in which to ameliorate non-compliance, Nasdaq would grant a company 180 days to regain compliance if the event causing non-compliance occurred less than 180 days before the next annual meeting.

Exemptions

NYSE. The NYSE proposes to exempt from all of the proposed requirements controlled companies, limited partnerships, companies in bankruptcy, closed-end and open-end funds registered under the 1940 Act, passive business organizations in the form of trusts, derivatives and special purpose securities, issuers whose only listed equity security is a preferred stock, and foreign private issuers that follow home country practice in lieu of compliance with the NYSE's compensation committee listing standard. Smaller reporting companies are exempt from the compensation independence standards of Section 303A.02(a)(ii) and the compensation adviser independence evaluation requirements of Section 303A.05(c)(iv) but must comply with all other applicable requirements of Section 303A.05(c)

Nasdaq. Nasdaq proposes that its existing exemptions from the compensation-related listing rules remain generally unchanged. Asset-backed issuers and other passive issuers, cooperatives, limited partnerships, management investment companies and controlled companies continue to be exempt. Moreover, Nasdaq proposes that a foreign private issuer continue to be allowed to follow its home country practice in lieu of Nasdaq's revised listing rules if the foreign private issuer provides the required disclosures. Although Rule 10C-1(b)(1)(iii)(A) expressly exempts companies in bankruptcy proceedings, neither the current nor proposed Nasdaq listing rules specifically provide for their exemption. Nevertheless, their exemption may be implied since companies emerging from bankruptcy are provided with the same phase-in schedule as are companies listing in connection with their initial public offerings.

Under Nasdaq's proposal, smaller reporting companies would be required to have a compensation committee comprised of at least two independent directors and a formal charter or board resolution that specifies the committee's responsibilities and authority. Smaller reporting companies would not have to adhere to the new independence requirements relating to compensatory fees and affiliation nor would such companies have to incorporate into their charter or board resolution the proposed language regarding compensation consultants, independent legal counsel and other advisers.



Client Alert

Effective Dates

Before the proposals can become effective, they must obtain SEC approval.

NYSE. Listed companies would have until the earlier of their first annual meeting after January 15, 2014, or October 31, 2014, to comply with the new compensation committee member independence standards in Section 303A.02(a)(ii). The NYSE's remaining amendments would become operative on July 1, 2013.

Nasdaq. Nasdaq's proposed Rule 5605(d)(3), relating to compensation committee responsibilities and authority, would be effective and require compliance immediately upon approval. Listed companies would have to comply with the remaining proposed provisions of Nasdaq's amended rules by the earlier of: (1) their second annual meeting held after the date of approval of Nasdaq's amended listing rules; or (2) December 31, 2014.

Comments and SEC Approval

Both proposals will be published by the SEC, and comments are due on or before the date that is 21 days from publication in the Federal Register. The NYSE and Nasdaq must have final rules in place no later than June 27, 2013.

Arnall Golden Gregory LLP serves the business needs of growing public and private companies, helping clients turn legal challenges into business opportunities. We don't just tell you if something is possible, we show you how to make it happen. Please visit our website for more information, www.agg.com.

This alert provides a general summary of recent legal developments. It is not intended to be, and should not be relied upon as, legal advice.