

Securities Regulation and Compliance Alert

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SEC Adopts Rules Requiring New Listing Standards for Compensation Committees

On June 20, 2012, the SEC adopted **rules**, first proposed in March 2011, to implement the Dodd-Frank Act's requirement that national securities exchanges adopt certain new listing standards applicable to compensation committees. The SEC also adopted a new issuer disclosure requirement relating to compensation-consultant conflicts of interest.

Practical effect; action items. The final rules should be published in the Federal Register in late June or early July. Exchanges then will have 90 days to propose changes to their listing standards, and the SEC must approve those changes within one year of the date of Federal Register publication of the rules.

The impact on compensation committee membership will not be known until the exchanges propose new listing standards, but we expect that most compensation committee members will continue to qualify as independent. Most of the other new requirements are not likely to impact the way compensation committees function currently or their choices of compensation consultants, counsel or other advisers. For instance, the SEC specifically noted in the adopting release that compensation committees will continue to be able to receive advice from in-house counsel or outside counsel retained by the company.

The new disclosure requirements — which apply to proxy statements for 2013 annual meetings — will require that compensation committees take another look at their current compensation consultants, assess whether conflicts of interest may exist (as articulated under the new rules), consider how to address those conflicts and determine what disclosures will be required under the new rules.

Revised listing standards. As a result of these new rules, listing standards must provide that:

- Each member of an issuer's compensation committee must be a member of the board of directors and must be independent;
- The compensation committee of a listed issuer, in its capacity as a committee of the board of directors:
 - may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser;

- shall be directly responsible for the appointment, compensation and oversight of the work of any compensation consultant, independent legal counsel or other adviser retained by the compensation committee;
- may select a compensation consultant, legal counsel or other adviser to the compensation committee only after taking into consideration the following factors, as well as any other factors identified by the exchange in its listing standards:
 - the provision of other services to the issuer by the person that employs the compensation consultant, legal counsel or other adviser;
 - the amount of fees received from the issuer by the person that employs the compensation consultant, legal counsel or other adviser, as a percentage of the total revenue of the person that employs the compensation consultant, legal counsel or other adviser;
 - the policies and procedures of the person that employs the compensation consultant, legal counsel or other adviser that are designed to prevent conflicts of interest;
 - any business or personal relationship of the compensation consultant, legal counsel or other adviser with a member of the compensation committee;
 - any stock of the issuer owned by the compensation consultant, legal counsel or other adviser; and
 - any business or personal relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the issuer.
- Each issuer must provide for appropriate funding, as determined by the compensation committee, for payment of reasonable compensation to a compensation consultant, independent legal counsel or any other adviser retained by the compensation committee.

The new rules also require the exchanges to consider relevant factors when determining the independence requirements for members of compensation committees. In accordance with the rules, those relevant factors to be considered by the exchanges (but not necessarily adopted as listing standards) include, but are not limited to:

- The source of compensation of a member of the board of directors of an issuer, including any consulting, advisory or other compensatory fee paid by the issuer to such director; and
- Whether a director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

The new rules will only be applicable to issuers with listed equity securities, and controlled companies and smaller reporting companies will be exempt from the revised listing standards. Certain other companies, including limited partnerships, companies in bankruptcy proceedings, open-end management companies and foreign private issuers, will be exempt from the requirement that the compensation committee members must be members of the board and otherwise independent. In the case of a foreign private issuer, however, the independence exemption requires that the foreign private issuer disclose in its annual report “the reasons that the foreign private issuer does not have an independent compensation com-

mittee.” The exchanges also were granted the authority to exempt certain relationships and issuers based on particular facts and circumstances.

New compensation consultant disclosure requirements. The SEC also adopted a new disclosure requirement that is triggered when a compensation consultant plays a role in determining or recommending the amount or form of executive and director compensation and that role “has raised any conflict of interest.” In those situations, issuers will be required to disclose information about the nature of the conflict and how the conflict is being addressed in any proxy or information statement for an annual meeting (or special meeting in lieu of an annual meeting) at which directors are to be elected.

This new disclosure rule (Item 407(e)(3)(iv) of Regulation S-K) does not specifically dictate the information that an issuer would be required to provide as to the nature of the conflict or how it is being addressed. The new rule does, however, include an instruction that states that the six factors listed above — which compensation committees must consider when selecting a compensation consultant, legal counsel or other adviser — should be considered when determining whether a conflict of interest exists.

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For additional information, please see the a copy of the [SEC adopting release](#) for the new rules and the [press release](#) issued by the SEC regarding the new rules.