

## NYSE and Nasdaq Propose New Compensation Committee Rules

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Pursuant to the Dodd-Frank Act and related SEC rules, the New York Stock Exchange (NYSE) and the Nasdaq Stock Market (Nasdaq) recently proposed amendments to their respective listing requirements relating to compensation committees of listed companies. Specifically, the proposed amendments:

- enhance the independence requirements for compensation committee members;
- specify compensation committee authority relating to compensation consultants, counsel and other advisers; and
- specify compensation committee responsibility to consider potential conflicts of interests when selecting compensation consultants, counsel and other advisers.

### Timing/Action Items

Comments on the proposed amendments will be due 21 days after publication in the Federal Register. As proposed, the enhanced compensation committee independence requirements will apply on the earlier of a company's 2014 annual meeting or October 31, 2014 (for NYSE companies) or December 31, 2014 (for Nasdaq companies). The proposed rules on committee authority and consideration of adviser conflicts would take effect on July 1, 2013 for NYSE companies and immediately upon SEC approval of the proposed amendments for Nasdaq companies.

*Review Compensation Committee Composition.* Once the amendments are finalized and approved, companies will need to review the composition of their compensation committees to assure compliance. As compensation committees members already are subject to independence requirements, many of them likely will continue to qualify as independent under the enhanced standards, although this may be less true under Nasdaq's proposed amendments. Nevertheless, boards of directors will need to go through the process of considering compensation committee members' independence under the new rules.

*Adopt Required Charter Amendments.* Companies also will need to review their compensation committee charter to make any changes necessary to comply with the new rules.

*Consider Adviser Conflicts of Interests.* In the case of committee consideration of adviser conflicts of interest, notwithstanding any transition period under the listing standards, new SEC rules (as described in our alert titled "SEC Adopts Rules Requiring New Listing Standards for Compensation Committees," June 22, 2012) will require disclosure in proxy statements for 2013 annual meetings as to whether retention of a compensation consultant raised any conflict of interest and how the conflict is being addressed. As a result, compensation committees will need to consider the proposed amendments relating to adviser conflicts as they engage compensation consultants, and eventually will need to extend that review to counsel and other committee advisers.

## Companies Subject to the Listing Standards

For both the NYSE and Nasdaq, the proposed amendments to the corporate governance requirements apply to companies with common equity securities listed on the exchange. As is currently the case, foreign private issuers may rely on home country standards and disclose how those standards differ from the exchange's standards applicable to U.S. companies. Smaller reporting companies are not wholly exempt from these rules, but would be exempt from the enhanced independence standards and the committee responsibility to review consultant, counsel and adviser conflicts of interests. The NYSE and Nasdaq would continue to apply phase-in periods for companies in connection with their IPOs and exclude controlled companies, companies in bankruptcy, open-end management investment companies registered under the Investment Company Act of 1940 and limited partnerships.

## Enhanced Compensation Committee Independence

*NYSE.* A member of the compensation committee of a NYSE-listed company would still be required to qualify as an independent director under the NYSE's general standards on director independence. In addition, as proposed, the board of directors would be required to affirmatively determine the independence of compensation committee members considering 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." Those factors would include:

- *Source of director's compensation:* Although the inquiry includes consulting, advisory or other compensatory fees paid by the listed company to the director, the NYSE commentary explains that the inquiry relates to whether the director receives compensation from any person or entity that would impair the director's ability to make independent judgments about the listed company's executive compensation.
- *Affiliation with the listed company:* The NYSE commentary explains that the board should consider whether the 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 the director's ability to make independent judgments about the listed company's executive compensation.

*Nasdaq.* While the NYSE approach leaves room for board judgment, the Nasdaq approach on consulting and advisory fees is a "bright line" approach equivalent to the audit committee independence standards. As proposed, a member of the compensation committee for a Nasdaq-listed company must qualify as an independent director under Nasdaq's general standards of director independence and must not accept, directly or indirectly, any consulting, advisory or other compensatory fees from the listed company or any subsidiary of the company. For this purpose, compensatory fees exclude fees for board and committee service and fixed amounts of compensation under a retirement plan for prior service. As is the case for audit committee independence, there is no "look back" for the "no consulting, advisory or compensatory fees" test.

In addition, the board must consider whether the compensation committee member is affiliated with the company and whether such affiliation would impair the director's judgment as a member of the compensation committee. In commentary, Nasdaq states that it does not believe that ownership of company stock, by itself, even if such ownership constitutes "control," precludes a determination that a director is able to serve on the compensation committee. The NYSE commentary retains existing language to the effect that ownership of even a significant amount of stock, by itself, does not preclude a finding of director independence.

## Compensation Committee Authority/Required Charter Amendments

As proposed, Nasdaq would require listed companies to have a compensation committee of at least two independent directors. Although Nasdaq currently provides that compensation matters may be handled by the independent directors as a group, as an alternate to having a compensation committee, most Nasdaq-listed companies already have a compensation committee with at least two independent directors.

Pursuant to the Nasdaq rules, the committee charter would have to reflect the committee's responsibilities, including structure, processes and membership requirements, as well as the committee's responsibility for determining (or recommending to the board of directors for determination) the compensation of the company's chief executive officer and all other executive officers of the company. The charter also would need to specify that the company's chief executive officer may not be present during voting or deliberations on his or her compensation. And finally, the committee charter must specify the specific committee responsibilities and authorities necessary to comply with the Dodd-Frank compensation committee rules. The committee is required to review and reassess the adequacy of the charter on an annual basis.

Pursuant to the NYSE rules, the compensation committee charter must be amended to reflect the rights and responsibilities of the compensation committee under the Dodd-Frank compensation committee rules. Although most NYSE-listed company charters already reflect the committee authority to retain consultants, counsel and advisers, charters will need to be amended with respect to committee consideration of adviser conflicts.

### Adviser Conflicts

Both the NYSE and Nasdaq proposed amendments would require compensation committee charters to reflect the committee's responsibility to consider conflicts of interest before selecting consultants, counsel or advisers. As set forth in the NYSE proposed amendment (whereas Nasdaq refers back to the SEC rule), the committee must take into consideration "all factors relevant to the person's independence from management" including:

- the provision of other services to the listed company by the person that employs the compensation consultant, counsel or other adviser (the Firm);
- the amount of fees received from the listed company by the Firm as a percentage of total Firm revenue;
- the Firm's policies and procedures designed to prevent conflicts of interest;
- any business or personal relationship of the compensation consultant, counsel or other adviser with a member of the compensation committee;
- any listed company stock owned by the consultant, counsel or adviser; and
- any business or personal relationship of the consultant, counsel or adviser or the Firm with an executive officer of the listed company.

Both NYSE and Nasdaq specify that there is no need for the committee to undertake this review in connection with obtaining the advice of in-house legal counsel. In addition, Nasdaq quoted the SEC in noting that compensation committees are free to select the advisers they prefer, including ones that are not independent, after considering the factors described above. Accordingly, compensation committees will continue to be able to receive advice from outside counsel retained by the company if they so choose.