

SEC ISSUES PROPOSED RULES REGARDING LISTING STANDARDS FOR COMPENSATION COMMITTEES

April 15, 2011

To Our Clients and Friends:

The Securities and Exchange Commission recently proposed rules that, among other things, direct each national securities exchange (*e.g.*, the NYSE and NASDAQ) to establish listing standards that require, subject to certain exceptions, each member of a listed equity issuer's compensation committee (or any other committee of the board that oversees executive compensation) to be a member of the board of directors and to be "independent," and provide that compensation committees must consider certain independence factors before engaging compensation advisers. The rule proposals also include new disclosure requirements concerning the use of such advisers and conflicts of interest that would apply to all reporting companies (whether or not listed). The rules are intended to implement the provisions of Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which added Section 10C to the Securities Exchange Act of 1934.

HIGHLIGHTS OF PROPOSED RULES

Independence Standards. Under the proposed rules, the exchanges are required to define independence standards, after taking into consideration "relevant factors," including, but not limited to: (i) the sources of compensation for a member of the board, including any consulting, advisory or other compensatory fee paid by the issuer to such member and (ii) whether a member of an issuer's board is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer. Neither Section 10C of the Exchange Act nor the proposed rules include a definition of "independent" for purposes of the listing standards to be established by the exchanges. Unlike existing independence requirements regarding audit committee membership, the proposed rules do not specify any relationships that would *per se* preclude independence nor do they include any safe harbors for particular relationships. Instead, the exchanges would have the flexibility to establish their own minimum independence criteria for compensation committee members after considering the factors noted above and identify particular relationships that should be exempted from the independence requirements, in each case subject to SEC review and approval. In addition, unlike the audit committee independence requirements, the proposed rules do not require that the exchanges prohibit all affiliates from serving on a compensation committee and, as a result, no separate definition of affiliate is included in the proposed rules.

Authority to Engage Compensation Advisers; Responsibilities and Funding. Restating the requirements set forth in Section 10C of the Exchange Act, the proposed rules provide that the compensation committee of a listed issuer may, in its sole discretion, retain or obtain the advice of a compensation consultant and independent legal counsel and other advisers (each a “compensation adviser”). The compensation committee would be directly responsible for the appointment, compensation and oversight of the work of its compensation advisers but need not implement or act consistently with the advice or recommendations of any such adviser. Further, a listed issuer must provide “appropriate funding,” as determined by the compensation committee, for the payment of “reasonable compensation” to its compensation advisers. While any such adviser need not itself be independent, the compensation committee must consider the following independence factors before selecting a compensation adviser:

- the provision of other services to the issuer by the person that employs the adviser;
- the amount of fees received from the issuer by the person that employs the adviser as a percentage of the total revenue of the person that employs the adviser;
- the policies and procedures of the person that employs the adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the adviser with a member of the compensation committee; and
- any stock of the issuer owned by the adviser.

In the proposing release, the SEC specifically declined to establish materiality or bright-line numerical thresholds that would determine whether or when any particular factors, including the foregoing, must be considered relevant by the compensation committee in connection with its evaluation.

Compensation Consultant Disclosure and Conflicts of Interest. The proposed rules would augment the existing disclosure requirements set forth in Item 407 of Regulation S-K by integrating the new disclosure requirements concerning compensation consultants and conflicts of interest set forth in Section 10C of the Exchange Act with those currently contained in Item 407. While many of the existing Item 407 disclosure requirements would remain unchanged, the general disclosure trigger would be revised. As a result, any issuer subject to the SEC’s proxy rules (including unlisted and controlled companies) would be required to disclose in a proxy or information statement for an annual meeting at which directors are to be elected if the compensation committee has retained or obtained the advice of a compensation consultant regardless of the extent or nature of the consultant’s role or information/advice provided by the

compensation consultant. In addition, such issuers would also be required to disclose whether the work of the consultant has raised any conflict of interest and, if so, a clear, concise and understandable description of the specific conflict and how the conflict has been addressed.

Under the proposed rules, a compensation committee will have “obtained the advice” of a compensation consultant if it has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship or payment of fees to the consultant for its advice. In determining whether a disclosable conflict of interest exists, the SEC has hewed closely to the open-ended language of Section 10C by not including a definition of “conflict of interest” in the proposed rules. Instead, issuers would need to consider all relevant factors, including the factors described above that a compensation committee must consider when retaining compensation advisers.

EXEMPTIONS UNDER THE PROPOSED RULES

Consistent with Section 10C of the Exchange Act, the following types of issuers would be exempt from any exchange requirements regarding the independence of compensation committee members:

- controlled companies;
- limited partnerships;
- companies in bankruptcy proceedings;
- registered open-end management investment companies; or
- any foreign private issuer that discloses to shareholders the reasons that it does not have an independent compensation committee.

The exchanges would also be authorized to identify and propose for SEC approval the exemption of any additional categories of issuers. Controlled companies would also be exempt from the proposed rules regarding the authority to engage compensation advisers, responsibilities, and funding. However, as noted above, controlled and unlisted companies subject to the SEC’s proxy rules would be required to comply with the revised disclosure requirements under Item 407 of Regulation S-K.

TRANSITION AND TIMING

The SEC included extensive requests for comments on the proposed rules in the proposing release and comments on the proposed rules are due by April 29, 2011. The SEC is required to issue rules mandated by Section 952 of Dodd-Frank by July 16, 2011. If adopted as proposed, the rules would leave many of the details to the exchanges and any listing standards proposed by the exchanges would be subject to SEC approval. In order to facilitate timely implementation, the SEC has proposed that each exchange must provide the SEC with proposed rules or rule amendments to its listing standards that comply with the SEC's final rules within 90 days after publication of the SEC's final rules, and the exchanges' new rules or rule amendments would have to be finalized within one year of such publication date. The SEC release may be found at <http://www.sec.gov/rules/proposed/2011/33-9199.pdf>

* * *

Please do not hesitate to call us if any of the proposed rules are of concern to you or to discuss the proposed rules and this memorandum generally.

Matthew E. Kaplan
+1 212 909 7334
mekaplan@debevoise.com

Elizabeth Pagel Serebransky
+1 212 909 6785
epagels@debevoise.com

Steven J. Slutzky
+1 212 909 6036
sjslutzky@debevoise.com