

CLIENT UPDATE

INDEPENDENCE DAY FOR COMPENSATION COMMITTEES: ADVISOR INDEPENDENCE ASSESSMENT REQUIRED AS OF JULY 1st

NEW YORK

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Independence Day is coming a little early this year to the compensation committees of equity issuers listed on the New York Stock Exchange (the “NYSE”) and the NASDAQ Stock Market LLC (“NASDAQ”). Beginning July 1, 2013:

- the compensation committee must have the authority to retain and oversee the work of its own independent compensation consultants, lawyers, and other advisors;
- the compensation committee must be provided with the funding needed to reasonably compensate the committees’ consultants, lawyers, and advisors, as determined by the committee; and
- prior to retaining or receiving the advice of any compensation consultant, lawyer, or other advisor, the compensation committee must consider the following six specific independence factors: (1) the provision of other services to the issuer by the advisor’s employer, (2) the amount of fees paid by the issuer to the advisor’s employer, as a percentage of the employer’s revenue, (3) the policies and procedures of the advisor’s employer that are designed to prevent conflicts of interest, (4) any business or personal relationships between the advisor and a member of the committee, (5) any stock of the issuer owned by the advisor, and

(6) any business or personal relationship between the advisor, or his or her employer, and any executive officer of the issuer.¹

Independence Assessment

Except in limited circumstances, the independence criteria must be assessed for any compensation consultant, lawyer (other than in-house counsel) or other adviser that provides advice to the compensation committee. Two exceptions to this general rule are if the advisor's role is limited to (a) consulting on a broad-based plan that does not discriminate in scope, terms or operation in favor of the issuer's executive officers or directors, and is available generally to all salaried employees, or (b) providing information that is not customized to the issuer or that is customized based on criteria that are not established by the advisor, and about which the advisor does not provide advice. While the compensation committee of a smaller reporting company must have the authority to retain its own advisors, the committee will not be obligated to engage in an independence assessment. Moreover, listed companies that are currently exempt from the listing rules (such as controlled companies, limited partnerships and companies in bankruptcy, passive issuers, etc.) are also exempt from the independence assessment rule. Foreign private issuers may follow their home-country rules instead of the NYSE/NASDAQ independence assessment rules so long as the issuer discloses on its Form 20-F (or in the case of an issuer listed on the NYSE, on the issuer's website) how the home-country rules followed by the company differ from the NYSE/NASDAQ rules.

Note that the committee does not have to retain or follow the advice of an independent advisor.

Compensation Committee Charter Provisions

To the extent an issuer has not already done so, the issuer should review its compensation committee charters and ensure that the charter contains provisions stating the committee's authority to retain its own advisors, the company's obligation to provide adequate funding, and the committee's requirement to assess (based on the six enumerated independence factors) its advisors' independence prior to retaining the advisor. NYSE-listed companies must include these provisions in their charters as of July 1, 2013. Issuers listed on the NASDAQ have until the earlier of (1) the issuer's second annual meeting held after January 11, 2013 and (2) December 31, 2014 to do so. However, NASDAQ listed issuers that choose to wait until then to amend their charters must provide their

¹ In addition to the six enumerated independence factors, the NYSE continues to require compensation committees to consider any other factor that would be relevant to determining the independence of advisors.

compensation committees with this authority by board resolution or other board action, subject to state law.

Annual Independence and Conflicts of Interest Disclosure

We would like to remind issuers that, in addition to the NYSE and NASDAQ rules, issuers are now required to annually disclose an issuer's use of compensation consultants and any related conflicts of interest, whether or not the issuer is listed on the NYSE or NASDAQ, if the consultant played any role in determining or recommending the amount or form of executive or director compensation, regardless of whether the consultant was retained by management or the compensation committee or any other board committee. The issuer must also disclose whether the work of the consultant raised any conflict of interest and, if so, a description of the specific conflict and how the conflict was addressed. When determining whether a conflict of interest exists, the issuer must consider all relevant factors, including, but not limited to, the six enumerated independence factors. In our experience, some companies ask their compensation consultants to provide a "comfort letter" or certification that indicates the consultant's independence and provides a basis to make this disclosure.

Independence of Compensation Committee Members

While we're at it, we would also like to remind issuers of the impending effective dates of the now SEC-approved compensation committee member independence rules that we discussed in our Client Update, Proposed NYSE and NASDAQ Listing Standards for Compensation Committees, dated October 31, 2012.² The NYSE rules will be effective by the earlier of (1) the first annual meeting after January 15, 2014 and (2) October 31, 2014. The NASDAQ rules, including the requirement to have a Compensation Committee, will be effective by the earlier of (1) the issuer's second annual meeting held after January 11, 2013 and (2) December 31, 2014.

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Please do not hesitate to contact us with any questions.

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² <http://www.debevoise.com/clientupdate20121031a/>