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Nasdaq Adopts New Compensation Committee Rule Amendments

As required by the Dodd-Frank Act and related SEC rules, Nasdaq has adopted new listing standards related to compensation committee independence and responsibilities. The final rules are being adopted substantially as proposed and add a new independence condition for compensation committee members, namely that they will be prohibited from accepting directly or indirectly any consulting, advisory or other compensatory fee from the company or its subsidiaries. Further, Nasdaq will require listed companies to have a formal compensation committee consisting of at least two independent members, eliminating the option for companies to have compensation matters handled by the independent directors in lieu of a formal compensation committee.

The NYSE has also adopted its corresponding new listing standards, which differ in significant ways from Nasdaq's final rules. For example, the NYSE does not add any additional mandatory standards for compensation committee membership, and instead outlines additional factors for the board to consider in determining compensation committee member independence. For more information on the final NYSE rules, see our memorandum on that topic at http://www.paulweiss.com/media/1430123/28-jan-13-nyse.pdf.

Compensation Committee Structure and Independence

Nasdaq's final rules will no longer allow companies to have compensation matters overseen by independent directors. Instead, all listed companies must have a compensation committee consisting of at least two directors, each of whom must meet enhanced independence requirements.

In addition to existing independence requirements, Nasdaq will prohibit compensation committee members from accepting directly or indirectly any consulting, advisory or other compensatory fee from the company or its subsidiaries (other than directors' fees or fixed compensation under a retirement plan (including deferred compensation) for prior service and that is not contingent on continued service). Further, Nasdaq will require boards, in determining whether a director is eligible to sit on the compensation committee, to consider whether the director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company in such a way as would impair the director's judgment as a compensation committee member. The final rules restate Nasdaq's position that stock ownership by itself, even a large share position, does not preclude compensation committee membership and in fact aligns a director's interests with those of the shareholders.

Nasdaq's existing rules allowing companies to have one non-independent director on the compensation committee in limited and exceptional circumstances remain unchanged. Nasdaq has, however, adopted a new cure period whereby if a member of the compensation committee ceases to be independent for reasons beyond the member's reasonable control, the company may cure the deficiency by the earlier of its next annual meeting or one year from the occurrence of the event that caused the director no longer to be independent for compensation committee purposes, provided that the company has at least 180 days from such event to regain compliance.

Compensation Committee Responsibilities

The compensation committee will be required to have a formal written charter that specifies the scope of the compensation committee's responsibilities and how it carries out those responsibilities, including structure, processes and membership requirements. Further, the compensation committee must review and assess the adequacy of its charter annually.

In addition to the compensation committee's existing responsibilities under Nasdaq rules, the compensation committee must have the following responsibilities and authority as set forth in the SEC's Rule 10C-1(b)(2), (3) and (4)(i)-(vi):

- Authority and funding by the company to retain or obtain the advice of any compensation consultants, legal counsel and other compensation advisors;
- Responsibility for the appointment, compensation and oversight of the work of those advisors; and
- Authority to engage advisors only after considering the six specified independence factors below:
    - the provision of other services to the company by the advisor's employer;
    - the fees received from the company by the advisor's employer, as a percentage of the total revenue of the employer;
    - the policies and procedures of the advisor's employer that are designed to prevent conflicts of interest;
    - any business or personal relationship of the advisor with a member of the compensation committee;
    - any stock of the company owned by the advisor; and

- any business or personal relationship of the advisor or the advisor's employer with an executive officer of the company.

Certain categories of compensation advisors are exempted from the new required assessments, namely in-house counsel and any compensation consultant, legal counsel or other advisor whose role is limited to (i) consulting on any broad-based plan that does not discriminate in scope, terms or operation in favor of executive officers or directors of the company and that is available generally to all salaried employees or (ii) providing information that is not customized for a particular company or is customized based on parameters that are not developed by the compensation consultant, and about which the compensation consultant does not provide advice.

There is no requirement that a compensation advisor be independent. Compensation committees may select, or receive advice from, any compensation advisor they prefer, including ones that are not independent, after considering the six independence factors outlined above. Further, Nasdaq specifies that the compensation committee is not required to implement or act consistently with the advice or recommendations of any advisor that it retains nor do its rules affect the ability or obligation of the compensation committee to exercise its own judgment in fulfilling its duties.

Implementation

The Amendments to effect the SEC's Rule 10C-1(b)(2), (3) and (4)(i)-(vi) regarding compensation committee responsibilities are effective July 1, 2013, and will also apply as of such date to independent directors who determine or recommend to the board for determination of CEO and other executive officer compensation in lieu of a compensation committee. Companies then have until the earlier of (i) their first annual meeting after January 15, 2014 and (ii) October 31, 2014 to comply with the remaining provisions (primarily the compensation committee independence and charter requirements).

In our experience, many existing Nasdaq companies have compensation committee structures, which already grant the committees the necessary authority and funding with respect to retaining advisors. Thus, most of the changes that boards will need to consider will center on any compensation committee membership, charter or procedure changes necessary to address the compensation committee and compensation committee advisor independence requirements.

Exemptions/Transition Periods

Any entities that are exempt from or have extended transition periods to comply with Nasdaq's compensation committee rules (*e.g.*, controlled companies, foreign private issuers, limited partnerships, cooperatives, newly listed companies, companies emerging from bankruptcy or controlled company status, companies transferring from other exchanges) will continue to have those same accommodations generally. Also, special accommodations and transition rules apply to smaller reporting companies.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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For a copy of the Nasdaq rule changes, see: http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2012/SR-NASDAQ-2012-109_Amendment_2.pdf