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SEC Adopts Final Compensation Committee Rules

The SEC has published final rules to implement Section 952 of the Dodd-Frank Act, which mandates new listing standards related to compensation committee independence and responsibilities and new disclosure requirements regarding compensation consultant conflicts of interest. The final rules largely reflect the proposed rules issued over a year ago, but with a few significant changes as highlighted below. These rules will apply to all issuers that list equity securities on a U.S. stock exchange, subject to certain limited exceptions.

The SEC has given the securities exchanges significant discretion with respect to the implementation of these new listing standards. As a result, the real impact of these rules will not be clear until the exchanges adopt their amendments, which must be proposed no later than 90 days, and finalized no later than one year, after publication of the SEC's final rules. The new compensation consultant conflicts of interest disclosure will be effective for any proxy or information statement for an annual meeting at which directors will be elected occurring on or after January 1, 2013.

Compensation Committee Requirements

Independence. The SEC's final rules on compensation committee independence are substantially similar to those proposed, with the most significant change being to extend the independence requirements to directors who, in the absence of a compensation committee, oversee executive compensation matters. Although the SEC declined to require companies to establish compensation committees, the alternative of having independent directors act on compensation matters in lieu of an established compensation committee may ultimately be eliminated for most U.S.-listed companies, as Nasdaq representatives have indicated that they are considering removal of, and the NYSE already does not allow, that option. For ease of use, any reference to compensation committees or compensation committee members in this memorandum should also be deemed to refer to other committees or directors who act on compensation matters in the absence of a compensation committee.

Under the final rules, the securities exchanges must issue listing standards to require U.S. listed company compensation committees to be fully independent, as determined pursuant to independence requirements that are adopted by the exchanges after *consideration* of relevant factors, including the director's source of compensation (such as consulting, advisory or other compensatory fees paid by the company) and whether the director is affiliated with the company or its subsidiaries. The SEC expressly noted that unlike the audit committee independence requirements mandated as minimum standards by the Sarbanes-Oxley Act, these new factors are only mandatory *considerations* and the exchanges retain the flexibility to adopt their own independence criteria after consideration of the relevant factors noted above. Both Nasdaq and the NYSE have acknowledged that significant share ownership alone should not be a bar to independence, particularly for executive compensation matters where the interests of shareholders as a whole are generally aligned. Thus, based on preliminary reports, a three-tiered independence scheme (e.g., general director independence, compensation committee independence and audit committee independence) may ultimately be adopted at one or both exchanges.

Responsibilities. Under the final rules, the securities exchanges must also issue listing standards requiring that compensation committees be authorized to retain or obtain the advice of compensation consultants, independent legal counsel and other compensation advisors, directly responsible for the appointment, compensation and oversight of the work of those advisors and appropriately funded for the committee's retention of those advisors.

When engaging advisors (other than in-house counsel), compensation committees must do so only after consideration of the six specified factors below, and any others that the securities exchanges may adopt:

- 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 (this being a new factor added in the final rules).

The SEC is not mandating that compensation advisors be independent, only that the compensation committee consider the foregoing independence factors when making the appointment. Further, there is no requirement that the compensation committee vet all compensation consultants retained by the company, only those that advise the committee.

Exemptions. Controlled and smaller reporting companies are not subject to the foregoing compensation committee independence and responsibility requirements. The definition of controlled companies has also been amended in the final rules to comport more with existing securities exchange definitions for such companies, namely that they are companies of which more than 50% of the voting power for the election of directors is held by another individual, group or company. Foreign private issuers are exempt from the compensation committee independence requirements (provided they disclose in their annual reports the reasons why they do not have an independent compensation committee), but they are not currently exempted from the compensation committee responsibility requirements. The SEC notes, however, that the securities exchanges have discretion to adopt further exemptions from those requirements as they deem appropriate.

Compensation Consultant Conflicts Disclosure

The final rules require that all companies subject to the U.S. proxy rules (including controlled companies, non-listed issuers and smaller reporting companies, but not foreign private issuers) disclose, with respect to any compensation consultants that had a role in determining or recommending the amount or form of executive and director compensation (subject to certain exclusions), whether that consultant's work raised any conflict of interest and, if so, the nature of such conflict and how it was addressed. In a departure from the proposed rules, the

trigger for this disclosure will remain consistent with existing rules – *i.e.*, companies would continue to be required to make these disclosures for those compensation consultants that had a role in determining or recommending the amount or form of executive and director compensation, subject to existing exemptions, such as consultants advising only on broad-based plans that do not discriminate in favor of executive officers or directors or those providing information that is not customized for a particular company. Further, in deciding whether there is a conflict of interest that must be disclosed, companies should consider, at a minimum, the compensation advisor independence factors discussed above. This new disclosure requirement applies only to compensation consultants and not other compensation advisors.

The SEC's final rules are available at <http://sec.gov/rules/final/2012/33-9330.pdf>

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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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