



**SEC APPROVES DODD-FRANK MANDATED RULES
ON LISTING STANDARDS FOR COMPENSATION COMMITTEES**

On June 20, 2012, the Securities and Exchange Commission (the “Commission”) adopted new rules and rule amendments to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which, among many other things, added new Section 10C to the Securities Exchange Act of 1934 (the “Exchange Act”). As required by Section 10C, the Commission approved [new rules](#) directing the national securities exchanges and national securities associations (the “Exchanges”) to adopt additional listing standards for public company boards of directors and compensation advisers.

SUMMARY

The changes are in two parts. The first part is a new rule directing the Exchanges to prohibit the listing of any equity security of a company that fails to meet new compensation committee independence standards¹, and the second part amends the compensation consultant disclosure required in proxy statements under Regulation S-K Item 407.

The new rule requires the Exchanges to adopt listing standards addressing:

- The independence of the members of a compensation committee;

¹ The new rules apply to any committee of the board that performs functions typically performed by a compensation committee, including oversight of executive compensation, whether or not such committee also performs other functions or is formally designated as a compensation committee.

- The compensation committee’s authority to hire and fire compensation advisers and its responsibility for the appointment, compensation, and oversight of the work of its advisers; and
- The compensation committee’s consideration of the independence of any of its advisers.

After the Exchanges’ new listing standards become effective, a listed company must satisfy the standards so that its shares can continue to be traded on the Exchanges. In addition, new disclosure is required in annual meeting proxy statements addressing whether the compensation committee retained or obtained the advice of a compensation consultant and whether the services of the compensation consultant raised any conflict of interest and, if so, the nature of the conflict and how the conflict was addressed.

**COMPENSATION COMMITTEE MEMBER
INDEPENDENCE**

Under new Rule 10C-1, the Exchanges are required to adopt listing standards that require each member of a company’s compensation committee to be a member of the board of directors and to be “independent” as defined by the Exchanges. The term “independent” is not defined in Section 10C. Instead, that section provides that the term “independent” is to be defined by the Exchanges after taking into consideration relevant factors, which must include (1) the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory, or other

compensatory fee paid by the issuer to such director, and (2) whether a director is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer. This new listing requirement is similar to the additional independence test for audit committee membership required by the Sarbanes-Oxley Act of 2002 (“SOX”); however, there is one major difference: Section 10C requires only that the Exchanges “consider relevant factors” while SOX expressly provides that certain relationships preclude an audit committee member from being independent. Under SOX an audit committee member may not, other than in his or her capacity as a member of the audit committee, accept any consulting, advisory, or other compensatory fee from the issuer, or be an affiliated person of the issuer or any subsidiary thereof.

Practical Considerations

We do not believe that the new rule and disclosure requirement will have a significant effect on most listed public companies. The NYSE Listed Company Manual already requires that an NYSE-listed company’s compensation committee be composed entirely of independent directors (under the general independence standards) and that the compensation committee have the sole authority to retain and terminate any compensation consulting firm that assists in evaluating director or executive officer compensation, including sole authority to approve the firm’s fees and other retention terms. Similarly, the NASDAQ governance listing rules require that the compensation of the chief executive officer of the listed company must be determined, or recommended to the board for determination, either by (1) the independent directors constituting a majority of the board’s independent directors in a vote in which only independent directors participate or (2) a compensation committee consisting solely of independent directors. As a practical matter in order to be independent under the Exchanges’ corporate governance rules, a director cannot have a material relationship with the issuer. In addition, most compensation committees already

consist solely of directors who qualify as both (1) “Non-Employee Directors,” as defined under the Exchange Act rules, in order for the committee to qualify to approve equity awards exempt from short-swing profit liability under Section 16(b) of the Exchange Act, and (2) “outside directors,” as defined under Rule 162(m) of the Internal Revenue Code. Once the Exchanges adopt the additional definition of “independence” for compensation committee purposes, we expect that the vast majority of currently serving compensation committee members will remain “independent” under the new standards.

AUTHORITY REGARDING COMPENSATION ADVISERS

Under new Rule 10C-1 the Exchanges are required to adopt listing standards providing that the compensation committee of a listed company may retain or obtain the advice of a compensation adviser and that the compensation committee is directly responsible for the appointment, compensation, and oversight of compensation advisers. Each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to compensation advisers.²

CONSIDERATIONS IN RETAINING COMPENSATION ADVISERS

Before selecting any compensation adviser, the compensation committee must take into consideration specific factors identified by the

² The Commission clarified in the adopting release that the final rule does not require compensation committees to retain or obtain advice only from independent advisers. A listed issuer’s compensation committee may receive advice from non-independent legal counsel, such as in-house counsel or outside counsel retained by management. The final rule does not require a compensation committee to be directly responsible for the appointment, compensation, or oversight of compensation advisers that are not retained by the compensation committee, such as compensation consultants or legal counsel retained by management.

Commission that may affect the independence of compensation advisers. The required listing standards must provide that a compensation committee may select a compensation consultant, legal counsel, or other adviser³ only after considering all of the following six independence factors:

- (1) whether the compensation consulting firm is providing any other services to the company;
- (2) how much the compensation firm has received in fees from the company, as a percentage of that firm's total revenue;
- (3) the policies and procedures adopted by the compensation consulting firm to prevent conflicts of interest;
- (4) whether the compensation adviser has any business or personal relationship with a member of the compensation committee;
- (5) whether the compensation adviser owns any stock of the company; and
- (6) whether the compensation adviser or the person employing the adviser has any business or personal relationship with an executive officer of the issuer.

The Exchanges may add other factors.

Neither Dodd-Frank nor new Rule 10C-1 requires that compensation advisers be independent, and compensation committees may select non-independent advisers. The only requirement is the committee's consideration of the above six summarized factors before selecting a compensation adviser.

EXEMPTIONS

Rule 10C-1 requires the Exchanges to exempt four categories of issuers from the compensation committee independence requirements: (1)

³ A listed issuer's compensation committee is required to conduct the independence assessment with respect to any compensation consultant, legal counsel, or other adviser that provides advice to the compensation committee, other than in-house legal counsel.

limited partnerships; (2) companies in bankruptcy proceedings; (3) open-end management investment companies registered under the Investment Company Act of 1940 (i.e., mutual funds); and (4) any foreign private issuer that discloses in its annual report the reasons that the foreign private issuer does not have an independent compensation committee. Also, Rule 10C-1 specifically exempts controlled companies and smaller reporting companies from the requirements of the new compensation committee listing standards.

As with all listing standards, the Exchanges must seek the approval of the SEC before adopting the new listing standards.

DISCLOSURE REGARDING COMPENSATION CONSULTANTS AND CONFLICTS OF INTEREST

Regulation S-K Item 407 already requires proxy statement disclosure of information about the use of compensation consultants, including specific information about fees paid to consultants. Under the new rules, Item 407 was amended to add proxy statement disclosure of the nature of the conflict and how the conflict was addressed for any compensation consultant whose work raises a conflict of interest.

EFFECTIVE DATES

The new rule becomes effective on July 27, 2012. Each national securities exchange and national securities association must provide to the Commission, no later than September 25, 2012, proposed rule change submissions that comply with the requirements of Exchange Act Rule 10C-1. Further, each national securities exchange and national securities association must have final rules or rule amendments that comply with Rule 10C-1 approved by the Commission no later than June 27, 2013. Issuers must comply with the disclosure changes in Item 407 of Regulation S-K in any proxy statement for an annual meeting of shareholders occurring on or after January 1, 2013 at which directors will be elected.

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ADDITIONAL INFORMATION

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