

LEGAL UPDATE

June 2012 *By: Michael T. Campoli*

SEC ADOPTS FINAL RULES REGARDING THE INDEPENDENCE OF COMPENSATION COMMITTEE MEMBERS AND ADVISERS, AND RELATED DISCLOSURE REQUIREMENTS

On June 20, 2012, the U.S. Securities and Exchange Commission (the “SEC”) adopted final rules to implement the provisions of Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Section 952 of the Dodd-Frank Act requires the SEC to direct the national securities exchanges to adopt listing standards that prohibit the listing of any equity security of an issuer that is not in compliance with the provisions of the Dodd-Frank Act regarding the independence of compensation committee members, the authority of the compensation committee to retain compensation advisers, and the responsibility of the compensation committee for the appointment, compensation and work of any compensation adviser.

The rules adopted by the SEC direct the national securities exchanges to establish listing standards that, among other things, (i) require each member of an issuer’s compensation committee to be “independent”, (ii) require compensation committees to consider certain “independence” factors before selecting compensation advisers, and (iii) provide compensation committees with greater authority and responsibilities regarding the selection and engagement of compensation advisers. In addition, revisions to Item 407(e)(3) of Regulation S-K will require enhanced disclosure in proxy and information statements for meetings at which directors are elected regarding any conflicts of interest that may exist between compensation consultants and the issuer.

TIMING

Once the SEC’s rules are published in the Federal Register, the national securities exchanges will have 90 days to provide to the SEC proposed listing standards that comply with the rules. These proposals will themselves be subject to review and comment by the SEC. Each exchange will be required to have final listing standards in place no later than one year after the SEC’s rules are published in the Federal Register.

Issuers must include the additional disclosure regarding conflicts of interest of compensation consultants in proxy or information statements for annual meetings (or special meetings in lieu of an annual meeting) at which directors will be elected occurring on or after January 1, 2013.

INDEPENDENCE OF COMPENSATION COMMITTEE MEMBERS

Rule 10C-1 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), requires the national securities exchanges (including the New York Stock Exchange, Nasdaq and the NYSE Amex) to establish listing standards that require each member of a listed issuer’s compensation committee (or each member of an issuer’s board of directors who oversees executive compensation matters on behalf of the board in the absence of a board committee) to be an “independent” member of the board of directors. Although “independence” is not defined, the SEC sets forth relevant factors that the exchanges should consider in developing their listing standards, including: (1) the source of compensation of a member of the board of directors, including any consulting, advisory or other compensatory fee paid by the issuer to such

member of the board of directors; and (2) whether a member of the board of directors of an issuer is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer.

The rules do not themselves establish independence standards or specifically prohibit any category of persons from being considered independent, but instead provide the exchanges with the flexibility to establish their own minimum independence criteria for compensation committee members after considering the relevant factors set forth above. This is a more flexible approach than the independence requirements for audit committee members under the Sarbanes-Oxley Act of 2002, which prohibited persons with certain specified relationships with an issuer, such as affiliates, from serving on the committee.

ENGAGEMENT OF COMPENSATION ADVISERS

The SEC is directing the national securities exchanges to prohibit the listing of the equity securities of any issuer that is not in compliance with the following requirements relating to the authority of compensation committees to retain, and their responsibilities with respect to, compensation advisers:

- the compensation committee must have the authority, in its sole discretion, to retain or obtain the advice of compensation consultants, independent legal counsel and other advisers;
- the compensation committee (or each member of a company's board of directors who oversees executive compensation matters on behalf of the board in the absence of a board committee) must be directly responsible for the appointment, compensation and oversight of the work of any compensation adviser retained by the compensation committee; and
- each listed issuer must provide appropriate funding for the payment of reasonable compensation, as determined by the compensation committee, to any compensation advisers retained by the compensation committee.

The rules do not require a compensation committee to retain independent legal counsel or preclude a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management. Also, the rules do not require compensation committees to implement or act consistently with the advice or recommendations of any compensation adviser.

INDEPENDENCE OF COMPENSATION ADVISERS

The new rules require the listing standards developed by the national securities exchanges for use in connection with the evaluation and selection of compensation consultants, legal counsel and other advisers to include certain factors relating to the independence of such advisers, including:

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

The exchanges may add other independence factors, in addition to the six factors listed above, that must be considered when selecting compensation advisers.

The compensation committee (or each member of a company's board of directors who oversees executive compensation matters on behalf of the board in the absence of a board committee) must take these independence factors, in their totality, into consideration before selecting a compensation adviser, other than in-house legal counsel.

However, the compensation committee is not required to select an adviser that is independent.

EXEMPTIONS

The following categories of issuers are exempt from the compensation committee member independence requirements and, therefore, cannot be delisted for not complying with such requirements: (1) limited partnerships; (2) companies in bankruptcy proceedings; (3) open-end management investment companies registered under the Investment Company Act of 1940; and (4) foreign private issuers that provide annual disclosures to shareholders of the reasons why the foreign private issuer does not have an independent compensation committee. In addition, controlled companies and smaller reporting companies will be exempt from all of the requirements of the new compensation committee listing standards. The exchanges may also exempt such other specific relationships and categories of issuers as they deem appropriate.

DISCLOSURE OF CONFLICTS OF INTEREST

The SEC is amending Item 407(e)(3) of Regulation S-K to add a new subsection (iv) thereto. New subsection (iv) requires disclosure of whether the work of any compensation consultant for whom disclosure is required pursuant to Item 407(e)(3)(iii) (i.e., any consultant that played any role in determining or recommending the amount or form of executive or director compensation, with limited exceptions) has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed.

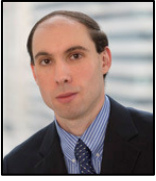
Although the term “conflict of interest” is not defined, issuers determining whether a “conflict of interest” exists must consider, at a minimum, the same six factors that are to be considered in evaluating the independence of compensation advisers. Issuers must also consider the specific facts and circumstances relating to a consultant’s engagement, and may consider other factors, in their determinations of whether there may be a conflict of interest. If the issuer determines that a conflict exists, it must include a concise and clear description of both the conflict and the manner in which it was addressed, not merely a description of the issuer’s general policies and procedures on resolving conflicts.

The enhanced disclosure regarding conflicts of interest will apply to all listed and unlisted Exchange Act registrants subject to the proxy rules, including controlled companies and smaller reporting companies.

The foregoing is merely a discussion of the SEC’s new rules regarding the independence and authority of compensation committees, and related disclosure requirements. If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Michael Campoli at 212-326-0468 or mcampoli@pryorcashman.com.

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Michael Campoli devotes his practice to counseling public and private companies on a broad range of corporate matters, including compliance with federal and state securities laws, reporting under the Securities Exchange Act, corporate formation and governance, mergers and acquisitions, public and private equity and debt financing transactions, and limited liability company and partnership counseling.

Mr. Campoli's work at Pryor Cashman has included the representation of:

- Marina Biotech, Inc. (OTCQX: MRNA) as outside general counsel in connection with its equity and debt financings, M&A initiatives and Exchange Act reporting requirements
- Javelin Pharmaceuticals, Inc. (NYSE Amex: JAV) as outside general counsel in connection with its equity financings and Exchange Act reporting requirements
- Henry Schein, Inc. (NASDAQ: HSIC) in connection with the acquisition of various private companies in the medical device and software industries
- Cowen and Company, LLC, Rodman & Renshaw, LLC and Global Hunter Securities, LLC in connection with various underwritten public offerings for domestic and foreign issuers
- Briad Restaurant Group in its prevailing tender offer for Main Street Restaurant Group, Inc., the largest T.G.I. Friday's franchisee
- The Kushner Companies in connection with its acquisition of the office building located at 666 Fifth Avenue, New York, New York
- A private telecommunications company in connection with the issuance of secured notes to the Rural Utilities Service of the U.S. Department of Agriculture and the concurrent placement of preferred stock to venture capital investors