King & Spalding

Public Company Advisor

Practical Insights for Public Company Counsel

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King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor *to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.*

New Listing Standards Affect Compensation Committees

In January 2013, the Securities and Exchange Commission approved new NYSE and Nasdaq listing standards addressing the independence of compensation committees and their advisers.

In this edition of the *Public Company Advisor*, we provide a brief overview of the new NYSE and Nasdaq listing standards requiring an assessment of compensation adviser independence. We then provide summaries of the new NYSE and Nasdaq listing standards related to compensation committee independence and compensation committee charters, including suggestions for implementing the new requirements.

Independence Assessment of Compensation Advisers

Under the new NYSE and Nasdaq listing standards, the compensation committee may engage compensation consultants, legal counsel or other advisers only after considering the six independence factors listed in the Appendix to this *Public Company Advisor*. For companies listed on the NYSE, the compensation committee must also consider all other factors relevant to the adviser's independence from management.

The compensation committee need not conduct an independence assessment prior to receiving advice from (i) in-house legal counsel or (ii) any consultant, counsel or adviser whose role is limited to:

- consulting on any broad-based plan that does not discriminate in favor of executive officers or directors and that is available generally to all salaried employees; or

- providing information that either is not customized for a particular company or that is customized based on parameters that are not developed by the adviser and about which the adviser does not provide advice.

There is no exception for a company's regular outside securities, tax or other counsel.

After the compensation committee has conducted the required independence assessment, it may engage the adviser regardless of its determination as to such adviser's independence.

NYSE — Summary of New Listing Standards for Compensation Committees

Independence of Compensation Committee Members (NYSE)

In determining the independence of directors appointed to the compensation committee (each of whom must also satisfy the general NYSE director independence standards), the board must consider all factors specifically relevant to the director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to:

- the source of compensation of the director, including any consulting, advisory or other compensatory fee paid by the company; and
- whether the director is affiliated with the company or any of its subsidiaries or its subsidiaries' affiliates.

The NYSE did not impose any "bright-line" standards with respect to these additional independence factors.

Cure Period: If a director serving on the compensation committee ceases to be independent for reasons outside the director's reasonable control, that director may remain a member of the compensation committee until the next annual shareholders' meeting or, if earlier, one year after the event that caused the director to be no longer independent if:

- the company gives prompt notice to the NYSE; and
- a majority of the members of the compensation committee continue to be independent.

Changes to Compensation Committee Charter (NYSE)

The compensation committee charter must address the committee's:

- right to retain or obtain advice from compensation consultants, counsel and other advisers;
- direct responsibility to appoint, compensate and oversee the work of compensation consultants, counsel and other advisers;
- right to determine appropriate funding from the company for payment of reasonable compensation to compensation consultants, counsel and other advisers; and
- responsibility to consider the six independence factors listed in the Appendix prior to retaining or obtaining advice from compensation consultants, counsel and other advisers.

Effective Dates (NYSE)

- By July 1, 2013, companies must be in compliance with the requirement to evaluate the independence of compensation consultants, counsel and other advisers and have in effect a committee charter that satisfies the requirements described above.
- By the date of their first annual meeting after January 15, 2014 or, if earlier, by October 31, 2014, companies must be in compliance with the new independence standards for compensation committee members.

Action Items for NYSE Companies

- Review the compensation committee charter and adopt any amendments necessary to satisfy the requirements described above.
- Evaluate the independence of compensation consultants, counsel and other advisers under the required six independence factors listed in the Appendix and all other factors relevant to independence from management.
- Evaluate the independence of compensation committee members under the new independence requirements.

<u>Nasdaq — Summary of New Listing Standards for Compensation Committees</u>

Compensation Committee Now Required; New Independence Standards (Nasdaq)

Companies must have a compensation committee composed of at least two directors, each of whom:

- satisfies the general Nasdaq director independence standards; and
- must not accept directly or indirectly any consulting, advisory or other compensatory fee from the company or any subsidiary (except for fees received for service on the board or a committee and amounts received under a retirement plan for prior service with the company).

In addition, when determining if a director is eligible to serve on the compensation committee, the board must consider whether the director is affiliated with the company to determine if such affiliation would impair the director's judgment. However, the listing standards do not impose a "bright-line" prohibition of an affiliated director serving on the compensation committee, and Nasdaq has noted that stock ownership by itself would not preclude service on the compensation committee.

<u>Exception</u>: A director who does not satisfy the applicable independence requirements may serve on the compensation committee (comprised of at least three members) for no longer than two years if:

- the board, under exceptional and limited circumstances, determines that the appointment is required by the best interests of the company and its shareholders;
- the director is not currently an executive officer, employee or family member of an executive officer; and
- the company discloses either on its website or in its next proxy statement the nature of the director's relationship with the company and the reason for its determination to appoint the director to the compensation committee.

<u>Cure Period</u>: If a compensation committee is no longer in compliance with the applicable independence requirements due to a vacancy or a member of the compensation committee ceasing to be independent due to circumstances outside the member's reasonable control, the company must:

- give notice to Nasdaq immediately upon learning of the event that caused the noncompliance; and
- regain compliance by its next annual meeting (or, if the meeting occurs within 180 days after the event that caused the noncompliance, by 180 days after the event) or, if earlier, one year after the event that caused the noncompliance.

Compensation Committee Charter Requirements (Nasdaq)

<u>General Rights and Responsibilities</u>: The compensation committee charter must address the committee's:

- scope of responsibilities and the means for carrying out those responsibilities (including structure, processes and membership requirements);
- responsibility to determine or recommend to the board the compensation of the CEO and all other executive officers; and
- responsibility to ensure that the CEO is not present during voting or deliberations on his or her compensation.

The compensation committee must review and reassess the adequacy of the charter on an annual basis.

<u>Nasdaq — Summary of New Listing Standards for Compensation Committees (cont'd)</u>

<u>Appointment of Advisers</u>: The compensation committee charter also must specifically address the committee's:

- right to retain or obtain advice from compensation consultants, counsel and other advisers;
- direct responsibility to appoint, compensate and oversee the work of compensation consultants, counsel and other advisers;
- right to determine appropriate funding from the company for payment of reasonable compensation to compensation consultants, counsel and other advisers; and
- responsibility to consider the six independence factors listed in the Appendix prior to retaining or obtaining advice from compensation consultants, counsel and other advisers.

Effective Dates (Nasdaq)

- By July 1, 2013, companies must delegate the rights and responsibilities related to the appointment of advisers described above to the compensation committee or, if the company has no compensation committee at that time, to the independent directors who determine, or recommend to the board, the compensation of the CEO and all other executive officers of the company.
- By the date of their first annual meeting after January 15, 2014 or, if earlier, by October 31, 2014, companies must have a compensation committee that satisfies the applicable director independence requirements and adopt a charter that satisfies the requirements described above.

Action Items for Nasdaq Companies

- Evaluate the independence of compensation consultants, counsel and other advisers under the required six independence factors listed in the Appendix.
- Establish a compensation committee of at least two members, if not already established.
- Evaluate the independence of compensation committee members under the new independence requirements.
- If no compensation committee charter is currently in place, adopt a charter that satisfies the requirements described above. If a charter is currently in place, review the charter and adopt any amendments necessary to satisfy the requirements described above.
- Prepare to provide a certification of compliance with the new listing standards within 30 days after the applicable implementation deadline (the date of the first annual meeting after January 15, 2014 or, if earlier, October 31, 2014).

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King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings, mergers and acquisitions and regulatory compliance and disclosure.

About King & Spalding

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The Public Company Advisor *provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. For more information on this issue of the* Public Company Advisor*, please contact:*

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APPENDIX

Compensation Adviser Independence Factors

1. The provision of other services to the company by the firm that employs the compensation consultant, counsel or other adviser.
2. The amount of fees paid by the company to the firm that employs the compensation consultant, counsel or other adviser, as a percentage of the firm's total revenue.
3. The policies and procedures of the firm that employs the compensation consultant, counsel or other adviser that are designed to prevent conflicts of interest.
4. Any business or personal relationship between the compensation consultant, counsel or other adviser and a compensation committee member.
5. Any company stock owned by the compensation consultant, counsel or other adviser.
6. Any business or personal relationship between the compensation consultant, counsel or other adviser or the firm that employs such person and an executive officer of the company.