

Small Business Securities Bulletin

A periodic bulletin keeping small businesses informed about current developments in securities law and related matters



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Nasdaq Proposes Rule Addressing Compensation Committee Independence, Smaller Reporting Company Exemptions

Independence; Compensation Committee Charter

If approved by the SEC, the proposed rule would require all Nasdaq-listed companies to have a compensation committee consisting of at least two independent directors. The current alternative allowing a listed company's independent directors to recommend or determine executive compensation would be eliminated. For listed companies that are not smaller reporting companies (generally, companies with a market capitalization (excluding shares held by affiliates) under \$75 million), compensation committee members also would be prohibited from accepting "any consulting, advisory or other compensatory fee from the [listed] company or any subsidiary thereof." This prohibition would not include payments for board or board committee service or fixed amounts under a retirement plan for prior service not contingent on continued service.

Nasdaq considered, but declined to prohibit, directors with any affiliation with a listed company, a subsidiary or a subsidiary of an affiliate from serving on the company's compensation committee. Under the proposed rule, however, listed companies' boards of directors would be required to consider whether any such affiliation would impair the director's judgment as a member of the compensation committee, but such an affiliation alone would not, unlike with respect to the audit committee, prohibit a director from so serving. Smaller reporting

companies are exempt from this new consideration as well. Therefore, smaller reporting companies that already have a compensation committee consisting of two or more directors who are independent under Nasdaq's current rules will not have to make changes to their compensation committee composition or their process for selecting compensation committee members.

The proposed rule would also preserve the existing exception that allows a non-independent director to serve on the compensation committee under "exceptional and limited circumstances."

In addition, under the proposed rule each listed company must adopt a compensation committee charter that specifies: "(A) the scope of the compensation committee's responsibilities, and how it carries out those responsibilities, including structure, processes and membership requirements; (B) the compensation committee's responsibility for determining, or recommending to the board for determination, the compensation of the chief executive officer and all other [Section 16(a) officers] of the Company; [and] (C) that the chief executive officer may not be present during voting or deliberations on his or her compensation." Smaller reporting companies may adopt a board resolution instead, but such resolution must delegate to the committee all of the authority and responsibilities that would otherwise be required in a charter.

Companies that are not smaller reporting companies must also include in their compensation committee charter (1) that the committee will review and reassess the adequacy of the charter on an annual basis and (2) the responsibilities and authority with respect to compensation advisers and consultants discussed below.

Compensation Consultants and Other Advisers

Nasdaq-listed companies that are not smaller reporting companies would also be required to provide in their compensation committee charters that the committee (1) "may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser" and (2) "must be directly responsible for the appointment, compensation and oversight of the work of any" such consultant or adviser. The charter must also provide that the company will provide funding for such consultants and advisers, and that the compensation committee must consider the independence factors set forth in Rule 10C-1(b)(4) under the Securities Exchange Act of 1934 before retaining any such adviser or consultant. Such independence factors include (1) other services provided to and fees received from the company by such consultant or adviser, (2) policies such adviser or consultant has in place to prevent conflicts of interest, (3) relationships between the adviser or consultant and the company, its executive officers or the compensation committee members, and (4) ownership of company stock by the adviser or consultant. Smaller reporting companies that retain compensation consultants will still need to obtain and consider this information, however, since conflict of interest disclosure is required in companies' proxy statements regarding compensation consultants (but not

counsel or other advisers) receiving more than \$120,000 from the company and who had any role in determining or recommending the amount or form of executive and director compensation.

Certification and Implementation

Listed companies would be required to certify that they are in compliance with the applicable provisions of the proposed rule within 30 days of the applicable listing requirement applying to them. Nasdaq will provide the required certification form to listed companies.

Nasdaq proposes that the provision of the proposed rule regarding compensation committee authority and responsibilities be effective immediately upon SEC approval. The remaining provisions would be effective the earlier of (1) a listed company's second annual meeting held after approval of the proposed rule or (2) December 31, 2014. Nasdaq-listed companies should ensure their compensation committees (or, if applicable, independent directors that recommend or determine executive compensation) are vested with the requisite authority and responsibilities, preferably by incorporation into their compensation committee charter, prior to approval of the proposed rule.

Nasdaq's rule proposal is available at <http://sec.gov/rules/sro/nasdaq/2012/34-68013.pdf>.

About Ober Kaler

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About Me

I am a former SEC attorney who also has prior "big firm" experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you. Visit my bio at www.ober.com/attorneys/penny-somer-greif.

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