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## Nasdaq Proposes Modifications to Compensation Committee Independence Requirements

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**On November 26, 2013, the NASDAQ Stock Market (“Nasdaq”) filed a proposal to amend its listing standards regarding compensation committee independence (the “Proposal”). The modifications would provide Nasdaq-listed companies with greater flexibility in determining compensation committee independence by eliminating the bright line prohibition on the receipt of compensatory fees by compensation committee members. Instead, boards of directors would only be required to “consider” the receipt of such fees when determining eligibility for compensation committee membership. Overall, the Proposal brings the Nasdaq standards in line with the current New York Stock Exchange (the “NYSE”) requirements.**

### Background

Pursuant to Rule 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, on June 20, 2012, the Securities and Exchange Commission (the “SEC”) issued final rules (the “Final Rules”) directing the national securities exchanges to adopt listing standards relating to the independence of compensation committees and their selection of advisors. The Final Rules provide that, at a minimum, in making an independence determination, boards must take into account (i) the source of the director’s compensation, including any consulting, advisory or other compensatory fees paid by the listed company and (ii) whether the director has an affiliate relationship with the company, a subsidiary of the company or an affiliate of a subsidiary of the company.

On January 11, 2013, the SEC approved final listing standards for both Nasdaq and the NYSE.<sup>1</sup> The Nasdaq listing standards are more stringent than the Final Rules and provide that a director will *not* be independent (and hence not eligible for compensation committee service), if the director receives *any* consulting, advisory or other compensatory fee from the listed company. Expressly excluded from this ban are fees received by the director as (i) a member of the board or any board committee and (ii) fixed amounts of compensation under a retirement plan for prior service with the company. In contrast, the NYSE listing standards require the board to consider “all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to the director’s ability to be independent from management,” including the two factors specified by the SEC. The NYSE did not provide for an outright prohibition for members of the compensation committee to receive compensation from the listed company.

## Proposed Amendments

### Source of Fees

Nasdaq has indicated that over the past few months it has received feedback from listed companies that the prohibition on compensatory fees creates a burden on issuers, particularly in industries such as energy and banking where it is common to have a director who conducts a *de minimis* amount of business with the issuer. These companies are concerned that they will have difficulty recruiting a sufficient number of eligible directors to serve on their boards and have indicated that this additional burden could influence a company’s choice of listing venue. To alleviate these burdens and remain competitive, Nasdaq has proposed to eliminate the prohibition and adopt the same standard used by the NYSE.

Under the Proposal, a company’s board must consider the source of *all* compensation of the director who will serve on the company’s compensation committee, including any consulting, advisory or other compensatory fee paid by the company to the director. The current exceptions for board and committee fees and retirement compensation would be eliminated and these amounts should be aggregated with all other sources of compensation. In reviewing the source of compensation, the board should consider whether the director receives compensation from any person or entity that would impair the director’s ability to make independent judgments about the company’s executive compensation.

In support of the Proposal, Nasdaq notes that, notwithstanding the elimination of the prohibition against compensation, a compensation committee member will not be allowed to receive unlimited fees as the member must continue to meet the general Nasdaq independence standards, which set overall caps on the amount of compensation that an independent director can receive from the company.<sup>2</sup> Under the Proposal, boards would need to consider whether any fees, even those below the caps, would impair a director’s ability to make independent judgments regarding executive compensation.

### Other Modifications

Nasdaq also proposes a few additional modifications. First, the Proposal provides that in affirmatively determining the independence of any director who will serve on the compensation committee, the board must “consider all factors

<sup>1</sup> For a discussion of the NYSE and Nasdaq listing standards see our client publication “SEC approves NYSE and Nasdaq Listing Standards for Compensation Committees and their Advisors,” available at <http://www.shearman.com/en/newsinsights/publications/2013/01/sec-approves-nyse-and-nasdaq-listing-standards-f...>

<sup>2</sup> These standards provide that a director will not be independent if (i) the director accepted or had a family member who accepted compensation from the company exceeding \$120,000 during any period of 12 consecutive months within the three years preceding the independence determination and (ii) the director is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for property or services in the current or any of the past three years that exceed the greater of 5% of the recipient’s gross revenues for that year or \$200,000.

specifically relevant to determining whether a director has a relationship to the company which is material to that directors' ability to be independent from management in connection with the duties of a compensation committee member." The NYSE listing standards contains the same requirement.

Second, the current listing standards (and the Final Rules) obligate the board to consider whether the director has an affiliate relationship with the company, a subsidiary of the company or an affiliate of a subsidiary of the company. The Proposal clarifies this requirement by providing that when considering any affiliate relationships that a director may have, the board should consider "whether the affiliate relationship places the director under the direct or indirect control of the company or its senior management, or creates a direct relationship between the director and members of senior management, in each case of a nature that would impair the director's ability to make independent judgments about executive compensation."

Finally, the Proposal clarifies the definition of "company" in the listing standards to include any parent, subsidiary or other entity that the company controls and consolidates with the company's financial statements as filed with the SEC.

### Effective Dates

The Proposal became effective immediately Pursuant to Rule 19b-4(f)(6) under the Securities Exchange Act, although Nasdaq provided for a 21-day comment period from the date of publication in the Federal Register. Nasdaq has not modified the implementation deadline for the compensation committee independence requirements and listed companies must comply with the rules by the earlier of their first annual meeting after January 2014 and October 31, 2014. Nasdaq has expressed the importance of the immediate implementation of the Proposal so that companies may ensure compliance by this deadline. Each listed company is required to submit a one-time certification of compliance with the amended rules within 30 days after the applicable implementation date. The certification form will be available on the Nasdaq OMX Listing Center no later than January 15, 2014.

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