

**SEC ISSUES PROPOSALS TO IMPLEMENT
DODD-FRANK ACT COMPENSATION COMMITTEE REQUIREMENTS**

April 12, 2011

The SEC recently issued rule proposals relating to compensation committee independence and compensation advisers.¹ The proposals are in response to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) enacted last year, which added new Section 10C to the Securities Exchange Act of 1934, as amended (the “Exchange Act”), requiring the SEC to adopt rules directing the national securities exchanges and national securities associations to adopt listing standards relating to (i) the independence of the members of a compensation committee, (ii) the committee’s authority to retain compensation consultants and other advisers and (iii) the committee’s responsibility for the appointment, compensation and work of any consultant or adviser. In addition, new Section 10C requires each company to disclose in its annual meeting proxy statement whether its compensation committee retained or obtained the advice of a compensation consultant and to disclose information about compensation consultant conflicts of interest. Comments on the SEC’s proposals are due by April 29, 2011.

Compensation Committee Member Independence

The proposed rules would direct the exchanges to adopt listing standards that require each member of a company’s compensation committee² to be a member of the board of directors and to be independent. In developing a definition of “independence,” the exchanges would be required to consider relevant factors, including, but not limited to:

- The source of compensation of a director, including any consulting, advisory or other compensatory fee paid by the issuer to such director; and
- Whether the director is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer.

Authority to Engage Compensation Advisers

Under the proposed rules, the exchanges would be required to provide in their listing standards that:

¹ Listing Standards for Compensation Committees, Release No. 33-9199 (March 31, 2011), available at <http://www.sec.gov/rules/proposed/2011/33-9199.pdf>.

² The listing standards would be applicable to any committee of the board that oversees executive compensation, whether or not the committee performs multiple functions and/or is formally designated as a “compensation committee.” Notably, the proposed rules do not mandate that the exchanges require listed companies to have a compensation committee, although current exchange listing standards generally require listed companies either to have a compensation committee or to have independent directors determine, recommend or oversee executive compensation matters.

- The compensation committee of a listed issuer may, in its sole discretion, retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser (as applicable, “adviser”);
- The compensation committee shall be directly responsible for the appointment, compensation and oversight of such adviser; and
- Each listed issuer must provide funding for payment of reasonable compensation to such adviser.

However, these requirements are not to be construed to require a compensation committee to implement or act consistently with the advice or recommendation of the adviser,³ or to affect the ability or obligation of a compensation committee to exercise its own judgment in fulfillment of its duties.

Independence of Compensation Consultants and Other Advisers

The Dodd-Frank Act does not require that an adviser be independent - only that the compensation committee consider certain factors before selecting an adviser. The proposals specify that a compensation committee of a listed issuer may select an adviser only after taking into account the following factors, as well as any other factors identified by the relevant exchange in its listing standards:

- The provision of other services to the issuer by the person that employs the adviser;
- The amount of fees received from the issuer by the person that employs the adviser, as a percentage of the total revenue of the person that employs the adviser;
- The policies and procedures of the person that employs the adviser that are designed to prevent conflicts of interest;
- Any business or personal relationship of the adviser with a member of the compensation committee; and
- Any stock of the issuer owned by the adviser.

Compensation Consultant Conflicts of Interest Disclosure

Exchange Act Section 10C requires that, in any proxy material for an annual meeting, each issuer must disclose whether:

- The compensation committee has retained or obtained the advice of a compensation consultant; and
- The work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed.

Because this requirement is similar to existing proxy disclosure requirements, the SEC proposes to integrate the new requirement with the requirements of existing Regulation S-K Item 407. The current exemption from disclosure for compensation consultants whose services are limited to consulting on broad-based plans would be deleted, but the exemption from disclosure of fees paid to such consultants would be retained.

Exemptions

The new listing standards are intended to apply only to issuers with listed equity securities, subject to certain exceptions. The following categories of issuers would be exempted from the proposed compensation committee member independence requirement: controlled companies, limited partnerships, companies in bankruptcy proceedings, open-end management investment companies registered under the Investment

³ The SEC noted that the rules would not require a committee to retain any advisers, nor would they preclude the committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management.

Company Act of 1940, as amended, and any foreign private issuer that discloses in its annual report its reasons for not having an independent compensation committee. The proposed rules would also authorize the exchanges to exempt particular relationships with respect to members of the compensation committee, taking into consideration the size of an issuer and any other relevant factors. The exchanges are authorized to exempt any additional category of issuer from the requirements of Section 10C, taking into account the impact on smaller reporting companies.

Timeline

The SEC is required to adopt final rules by July 16, 2011. As proposed, the exchanges would be required to submit proposed listing standards to the SEC within 90 days after publication of the final SEC rules and to have final listing standards approved by the SEC no later than one year after publication of the SEC's final rules. The rules regarding new proxy statement disclosure about compensation consultants would take effect on the date specified in the SEC's final rules.

Conclusion

It is not yet clear how the Dodd-Frank Act compensation committee and adviser requirements will impact existing SEC and exchange structural and disclosure requirements affecting compensation committees. Although the Dodd-Frank Act requirements are subject to final SEC and exchange rulemaking, listed companies should begin now to assess how the proposals may impact compensation committee composition and function and their engagement of consultants and other advisers. Once the final rules are implemented, listed companies will need to not only comply with the new requirements but also to modify their compensation committee charters (and possibly other corporate documents) to address the new requirements.

If you have any questions regarding the SEC proposals, please contact [Meredith Burbank](#), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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