

April 28, 2011

Milbank

Corporate Governance Group

Client Alert

Beijing Frankfurt Hong Kong London Los Angeles Munich New York São Paulo Singapore Tokyo Washington, DC

SEC PROPOSES NEW RULES REQUIRING STOCK EXCHANGE LISTING STANDARDS FOR COMPENSATION COMMITTEES

New rules also would require enhanced disclosures relating to compensation committee consultants and advisers

One area of reform addressed by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”)¹ is the independence of public company compensation committees and their advisers. In this regard, Section 952 of the Dodd-Frank Act added Section 10C to the Securities Exchange Act of 1934 (the “Exchange Act”), which requires the Securities and Exchange Commission (“SEC”) “to adopt rules directing the national securities exchanges to . . . prohibit the listing of any equity security of an issuer,” with certain specific exceptions, “that is not in compliance with Section 10C’s compensation committee and compensation adviser requirements.”

As required by Exchange Act Section 10C, on March 30, 2011, the SEC published a release (the “Release”)² which proposes a new Rule 10C-1 under the Exchange Act and amendments to Item 407 of Regulation S-K. As described in the Release, Proposed Rule 10C-1 focuses on ensuring the independence of compensation committee members by directing the national securities exchanges to “establish listings standards that . . . require each member of a listed issuer’s compensation committee to be . . . ‘independent’ as defined in the listing standards of the exchange.” The proposed amendments to Regulation S-K Item 407 would implement Exchange Act Section 10C(c)(2)’s requirement that issuers provide greater disclosure regarding their compensation committees’ use of various compensation advisers and consultants, as well as any conflict of interest arising from such use.

¹ For a further discussion of the Dodd-Frank Act, please see our Client Alerts entitled “Corporate Governance Highlights of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010” (July 21, 2010); “‘Accredited Investor’ Standard for Reg D Offerings Tightened by Wall Street Reform Act” (August 4, 2010); “SEC Adopts Long-Awaited Proxy Access Rules” (September 14, 2010); “SEC Adopts New Rules for Shareholder ‘Say on Pay’ Votes on Executive Compensation and Golden Parachutes” (February 10, 2011); and “SEC Staff Issues Guidance on Shareholder ‘Say on Pay’ Voting” (March 8, 2011).

² See Release No. 33-9199 entitled “Listing Standards for Compensation Committees,” which is available on the SEC website at <http://www.sec.gov/rules/proposed/2011/33-9199.pdf>.

For further information about this Client Alert, please contact:

Paul Wessel
Partner
212-530-5077
pwessel@milbank.com

David Schwartz
Of Counsel
212-530-5260
dschwartz@milbank.com

Kevin Brown
Associate
212-530-5551
kbrown@milbank.com

George Esposito
Associate
212-530-5787
gesposito@milbank.com

Roxana Azizi
Associate
212-530-5276
razizi@milbank.com

You may also contact any member of Milbank’s Corporate Governance Group. Contact information can be found at the end of this Client Alert. In addition, if you would like copies of our other Client Alerts, please visit our website at www.milbank.com and choose the “Client Alerts & Newsletters” link under “Newsroom/Events.”

This Client Alert is a source of general information for clients and friends of Milbank, Tweed, Hadley & McCloy LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel. © 2011 Milbank, Tweed, Hadley & McCloy LLP. All rights reserved. Attorney Advertising. Prior results do not guarantee a similar outcome.

Editor: Bob Reder

www.milbank.com

The comment period for the SEC's proposed rule and amendments expires on April 29, 2011. Further, once the SEC takes final action, the exchanges will have 90 days in which to propose new listing standards to comply with the SEC rule-making, and such new listing standards will be required to be effective by the first anniversary of the adoption of Rule 10C-1.

Compensation Committees

Proposed Rule 10C-1(b)(1)(i) would require that each member of a listed issuer's³ compensation committee, or "any [other] committee of the board that oversees executive compensation," no matter how denominated and regardless of whether the committee has other responsibilities as well, be an "independent" member of its board of directors. The proposed rule does not define independence, nor does it impose specific independence standards. Instead, the proposed rule would direct the exchanges to develop their own definitions after considering "relevant factors," including "any consulting, advisory, or other compensatory fee paid by the issuer to [a] member of the board of directors" and whether any director "is affiliated with the issuer, a subsidiary of the issuer, or an affiliate of a subsidiary of the issuer." The SEC emphasizes the considerable "discretion" and "flexibility" granted to the exchanges to set "their own minimum independence criteria for compensation committee members," particularly in contrast with the more stringent requirements of Exchange Act Section 10A(m) relating to audit committee independence under which, for instance, affiliated shareholders are conclusively deemed not to be independent.⁴

It should be noted that neither the SEC's current rules nor its proposed rules require that listed issuers create a compensation committee. On the other hand, current exchange listing standards do mandate that a listed issuer either have a compensation committee or require their independent directors to manage executive compensation matters.⁵ In the form currently proposed, however, because Section 10C "refers only to compensation committees," Rule 10C-1 does not require that the new listing standards apply to independent directors determining executive compensation in the absence of a compensation committee.

Compensation Advisers

Proposed Rule 10C-1(b)(2) directs the exchanges to prohibit the listing of any security of an issuer that does not provide its compensation committee with the authority to "retain or obtain the advice of a compensation consultant, independent legal counsel or other adviser." The proposed rule also provides that the compensation committee shall be "directly responsible" for overseeing and compensating its compensation advisers. Further, to ensure adequate funds to compensate compensation committee advisers, the proposed rule states that listed issuers "must provide for appropriate funding, as determined by the compensation committee," for this purpose.

³ Although there is some inconsistent language in Section 952 of the Dodd-Frank Act, proposed Rule 10C would apply only to issuers with listed "equity" securities and not, as in the case of the SEC's audit committee rules, issuers with listed debt securities.

⁴ Exchange Act Section 10A(m) actually *prohibits* an audit committee member from being "an affiliated person of the issuer or any subsidiary thereof." While the exchanges would not be required to extend Exchange Act Section 10A(m)'s restrictions on audit committee members to compensation committee members, the Release sets forth the SEC's belief that the exchanges will consider those factors in developing their definitions of compensation committee member independence.

⁵ For example, the New York Stock Exchange not only requires a listed issuer to have a compensation committee, but further mandates that the committee be "composed solely of independent directors." On the other hand, the Nasdaq Stock Market does not require listed issuers to establish compensation committees, but does require executive compensation to be determined "either by a compensation committee composed solely of independent directors or by a majority of the board's independent directors in a vote in which only independent directors participate."

While Exchange Act Section 10C would not require that compensation committee advisers be independent, the proposed rule would provide that the new listing standards require that compensation committees consider the following independence factors before retaining a compensation adviser (as well as any other factors identified by the applicable exchange):

- the provision of other services to the issuer by the compensation committee adviser;
- the percentage of the compensation committee adviser's total revenue that is represented by the fees received from the issuer;
- the policies and procedures of the compensation committee adviser that are designed to prevent conflicts of interest;
- any business or personal relationship of the compensation committee adviser with a member of the compensation committee; and
- any stock of the issuer owned by the compensation committee adviser.

Opportunity to Cure Defects

Proposed Rule 10C-1(a)(3) would require the exchanges to establish procedures affording issuers the “reasonable opportunity to cure any defects” that would result in delisting of an issuer’s securities as a result of failure to comply with the compensation committee listing standards.⁶ The proposed rule also would allow individual compensation committee members to cure violations of the independence requirements while remaining on the committee until the earlier of the issuer’s next annual meeting or one year from the event that caused the independence violation.

Exemptions

Consistent with Section 10C, proposed Rule 10C-1(b)(1)(iii) provides various exempt categories of issuers, including “controlled companies,” companies in bankruptcy and any foreign private issuer which provides annual disclosures to its shareholders as to why it does not have an independent compensation committee. The proposed rule also authorizes the exchanges to exempt from their independence requirements certain relationships of their choosing between compensation committee members and the issuers. Finally, consistent with the mandate of the Dodd-Frank Act, the exchanges would be permitted to consider exemptions for both issuers and their compensation committee members “taking into account the size of an issuer.”

Proposed Amendments to Item 407 of Regulation S-K

Item 407 of Regulation S-K requires registrants that are subject to the Exchange Act proxy rules to provide various disclosures concerning their compensation committees and the use of compensation consultants. The proposed amendment to Item 407 would, consistent with Exchange Act Section 10C(c)(2), broaden the scope of disclosure currently required by mandating disclosure as to whether the compensation committee “retained or obtained the advice of a compensation consultant during the registrant’s last completed fiscal year” If so, disclosure will be required as to “the nature and scope of the consultant’s assignment and the material elements

⁶ The Release acknowledges that the stock exchange listing standards, for the most part, currently include cure provisions.

of the instructions or directions given to the consultant with respect to the performance of the consultant's duties under the engagement" Such disclosure would be required only for proxy and information statements for annual meetings (or a special meeting in lieu of an annual meeting) at which directors are to be elected.

As amended, Regulation S-K Item 407 would require disclosure even if a consultant only provides advice on "broad-based plans" or provides only "non-customized benchmark data." Moreover, under certain circumstances, disclosures are required as to management's involvement in the retention of the consultant.

The instructions to the compensation consultant fee disclosure requirements of Regulation S-K Item 407 also are proposed to be amended to clarify that the phrase "obtained the advice" relates to circumstances in which a compensation committee or management "has requested or received advice from a compensation consultant, regardless of whether there is a formal engagement of the consultant or a client relationship between the compensation consultant and the compensation committee or management or any payment of fees to the consultant for its advice."

Finally, the amendments to Regulation S-K Item 407 would require enhanced disclosure whether the work of a compensation consultant "has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed"

* * *

We will publish an update of this Client Alert when the SEC finalizes the proposed rules.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Corporate Governance Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2
China Central Place, 79 Jianguo Road, Chaoyang District
Beijing 100025, China

Anthony Root	+86-10-5969-2777	aroot@milbank.com
Edward Sun	+86-10-5969-2772	esun@milbank.com

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main, Germany

Norbert Rieger	+49-89-25559-3620	nrieger@milbank.com
----------------	-------------------	---------------------

Hong Kong

3007 Alexandra House, 18 Chater Road
Central, Hong Kong

Anthony Root	+852-2971-4842	aroot@milbank.com
Joshua Zimmerman	+852-2971-4811	jzimmerman@milbank.com

London

10 Gresham Street
London EC2V 7JD, England

Stuart Harray	+44-20-7615-3083	sharray@milbank.com
---------------	------------------	---------------------

Los Angeles

601 South Figueroa Street, 30th Floor
Los Angeles, CA 90017

Ken Baronsky	+1-213-892-4333	kbaronsky@milbank.com
Neil Wertlieb	+1-213-892-4410	nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhöfe)
80539 Munich, Germany

Peter Nussbaum	+49-89-25559-3430	pnussbaum@milbank.com
----------------	-------------------	-----------------------

New York

One Chase Manhattan Plaza
New York, NY 10005

Scott Edelman	+1-212-530-5149	sedelman@milbank.com
Roland Hlawaty	+1-212-530-5735	rhlawaty@milbank.com
Thomas Janson	+1-212-530-5921	tjanson@milbank.com
Joel Krasnow	+1-212-530-5681	jkrasnow@milbank.com
Alan Stone	+1-212-530-5285	astone@milbank.com
Douglas Tanner	+1-212-530-5505	dtanner@milbank.com
Paul Wessel	+1-212-530-5077	pwessel@milbank.com

São Paulo

Rua Colombia, 325
Jardim América
São Paulo, SP
01438-000

Andrew Janszky	+55-11-3927 7701	ajanszky@milbank.com
----------------	------------------	----------------------

Singapore

30 Raffles Place, #14-00 Chevron House
Singapore 048622

David Zemans	+65-6428-2555	dzemans@milbank.com
Naomi Ishikawa	+65-6428-2525	nishikawa@milbank.com

Tokyo

21F Midtown Tower, 9-7-1 Akasaka, Minato-ku
Tokyo 107-6221 Japan

Gary Wigmore	+813-5410-2840	gwigmore@milbank.com
--------------	----------------	----------------------

Washington, DC

International Square Building, 1850 K Street, NW
Suite 1100

Washington, DC 20006		
Glenn Gerstell	+1-202-835-7585	gerstell@milbank.com