

Nasdaq Proposes Tweaks to Independence Requirements for Compensation Committee Members

On November 26, 2013, the Nasdaq Stock Market filed a proposal to amend its listing rules implementing Rule 10C-1 of the Securities Exchange Act of 1934, governing the independence of compensation committee members.¹ Currently, Nasdaq Listing Rule 5605(d)(2)(A) and IM-5605-6 employ a bright line test for independence that prohibits compensation committee members from accepting directly or indirectly **any** consulting, advisory or other compensatory fees from the company or any subsidiary. The requirement is subject to exceptions for fees received for serving on the board of directors (or any of its committees) or fixed amounts of compensation under a retirement plan for prior service with the company provided that such compensation is not contingent on continued service.

This bright line prohibition is more stringent than the Rule 10C-1 mandate, which only requires that listing rules obligate boards to **consider compensatory fees** when determining independence for compensation committee purposes. Nasdaq's current bright line rule has posed challenges for some issuers such as portfolio companies of private equity firms that have been taken public, particularly when the company pays² management fees to the private equity sponsor or one of its affiliated entities of which the compensation committee member is an employee or partner.

Based on the potential burden the bright line approach places on companies' ability to recruit eligible directors, Nasdaq has proposed to replace its rule, and its exceptions for board fees and retirement plan compensation, with a requirement that all compensation received from a company be considered in the independence determination. For this purpose, "company" includes any parent or subsidiary, which is intended to cover entities controlled by the company and consolidated with the company's financial statements as filed with the U.S. Securities and Exchange Commission (but not if the company reflects such entity solely as an investment in its financial statements). The revision would make the rule consistent with the mandate of Rule 10C-1 and mirror the NYSE listing standards.

Notwithstanding the proposed change, compensation committee members would still be required to be "Independent Directors" within the meaning of Listing Rule 5605(a)(2), which imposes thresholds on the amount of fees that may be received by them. Under Rule 5605(a)(2), the term "Independent Director" excludes any director who: (i) accepted compensation from the company exceeding \$120,000 during a 12-month period within the prior three years; or (ii) is a partner, controlling shareholder or executive officer of an organization to

¹ See SR-NASDAQ-2013-147, available at <http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2013/SR-NASDAQ-2013-147.pdf>.

² While the prohibition does not contain a look-back period, compensation committee members must also be "Independent Directors" as defined in Listing Rule 5605(a)(2), and each of the bright-line tests under that definition includes a three-year look-back period.

which the company made, or from which the company received, payments for property or services in the current or any of the past three fiscal years that exceed the greater of 5% of the recipient's consolidated gross revenues for that year or \$200,000.

Nasdaq has also proposed changes to Listing Rule 5605(d)(2)(A) and IM-5605-6 to elaborate on the affiliation prong of the compensation committee independence test. Rule 10C-1 requires that consideration be given in independence determinations to whether a compensation committee member is affiliated with the issuer, a subsidiary of the issuer or an affiliate of a subsidiary of the issuer. Listing Rule 5605(d)(2)(A) would be revised to clarify that in affirmatively determining the independence of any director who will serve on the compensation committee, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the company that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member. However, as the proposal notes, this would not constitute a substantive change since the "Independent Director" definition already requires the board to make an affirmative determination that the director has no relationship with the company that would interfere with the exercise of independent judgment. IM-5605-6 would also be revised to state that when considering any affiliate relationship a director has with a company, one of its subsidiaries, or an affiliate of one of its subsidiaries, "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 the Company's executive compensation." Both of these changes would align Nasdaq's approach to the affiliation prong of Rule 10C-1 with that employed by the NYSE.

The proposal calls for a 21-day comment period from the date of publication in the Federal Register. Nasdaq has emphasized the need for prompt implementation of these changes since companies are required to comply with the enhanced independence standards under Rule 10C-1 by the earlier of their first annual meeting after January 15, 2014, or October 31, 2014.

Please feel free to call any of your regular contacts at the firm or any of the partners and counsel under [Executive Compensation and ERISA](#) in the Practices section of our website (www.cgsh.com) if you have any questions.

CLEARY GOTTlieb STEEN & HAMILTON LLP

Office Locations

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Cleary Gottlieb Steen & Hamilton (Hong Kong)
Hysan Place, 37th Floor
500 Hennessy Road
Causeway Bay
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI

Al Sila Tower, 27th Floor
Sowwah Square, PO Box 29920
Abu Dhabi, United Arab Emirates
T: +971 2 412 1700
F: +971 2 412 1899

SEOUL

Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099