Nasdaq Proposes Clarifying Amendments to Proposed Compensation Committee Listing Standard

Recently, The NASDAQ Stock Market LLC ("Nasdaq") filed a partial amendment to its pending rule proposal that would amend certain of its rules relating to listing standards for compensation committees and advisors.[1] The partial amendment clarifies certain provisions in the proposed rules.[2]

I. Timing of Required Compliance

Proposed Nasdaq Listing Rule 5605(d)(3), which requires compensation committees to have the specific responsibilities and authority necessary to comply with Rule 10C-1(b)(2), (3) and (4)(i)-(vi) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") will be effective on July 1, 2013 rather than immediately upon approval of the rule.

To the extent a Company does not have a compensation committee in the period before the final implementation deadline applicable to it, the provisions of the rule will apply to the Independent Directors (as defined in Nasdaq Rule 5605(a)(2)) who determine, or recommend to the board for determination, the compensation of the chief executive officer and all other Executive Officers of the Company. Companies must comply with the remaining provisions of the amended listing rules, as set forth in proposed Nasdaq Listing Rule 5605(d) and IM-5605-6, by the earlier of: (1) their first annual meeting after January 15, 2014; or (2) October 31, 2014.[3]

Until a Company is required to comply with a particular provision of the amended listing rules, it must continue to comply with the corresponding provision, if any, of Nasdaq's existing listing rules relating to Independent Director oversight of executive compensation, which have been redesignated as Nasdaq Listing Rule 5605A(d) and IM-5605A-6.

II. Independence Considerations Applicable to Retention of Legal Counsel to Compensation Committee

The proposed listing rule requires a compensation committee to have the specific responsibilities and authority necessary to comply with Rule 10C-1(b)(2), (3) and (4)(i)- (vi) under the Exchange Act relating to the retention, compensation, oversight and funding of compensation consultants, legal counsel and other compensation advisers, as well as the requirement to consider the six independence factors enumerated in Rule 10C-1(b)(4) before selecting, or receiving advice from, such advisers.

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1 For a summary of the initial proposals see our Firm Memorandum *NYSE and Nasdaq Propose Changes to Listing Standards Regarding Compensation Committees and Compensation Advisers* (October 11, 2012) at http://www.cahill.com/publications/firm-memoranda/1012971/_res/id=Attachments/index=0/NYSE%20and%20Nasdaq%20Propose%20Changes%20to%20Listing%20Standards.pdf.

2 The partial amendment filing is available at http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2012/SR-NASDAQ-2012-109_Amendment_1.pdf.

3 Nasdaq's original rule proposal would have required compliance by the earlier of the time of a company's second annual meeting two years after the date the Nasdaq rule amendment was approved, or December 31, 2013. In its rule filing, Nasdaq said that the revised timing was modeled on the transition periods used when Nasdaq implemented similar requirements for audit committees.

The intent of Rule 10C-1(b)(4)(i)-(vi) is to require compensation committees to consider the independence factors when selecting any compensation consultant, legal counsel or other compensation adviser, other than in-house legal counsel. Accordingly, in the partial amendment recently filed, Nasdaq has deleted the word "independent" prior to "legal counsel" to make it clear that the compensation committee has to consider independence factors prior to seeking advice from *any* legal counsel, other than in-house counsel. Note, however, a compensation committee is not required to retain an independent compensation adviser; rather, a compensation committee is required only to consider the independence factors.

III. Phase-in for Smaller Reporting Companies

Nasdaq also proposes to allow a company that has ceased to be a Smaller Reporting Company to phase-in a fully compliant compensation committee. Pursuant to Rule 12b-2 under the Exchange Act, a company tests its status as a Smaller Reporting Company on an annual basis at the end of its most recently completed second fiscal quarter. A company with a public float of $75 million or more as of the last business day of its second fiscal quarter as calculated pursuant to Rule 12b-2 will cease to be a Smaller Reporting Company as of the beginning of the next fiscal year (the "Start Date").

Within six months from the Start Date (i.e., within six months after the beginning of its fiscal year), a company that has ceased to be a Smaller Reporting Company must comply with the requirements of Rule 5605(d)(3) relating to certain compensation committee responsibilities and authority as summarized above.[4] In addition, such a company may phase in its compliance with the additional compensation committee composition requirements of Rule 5605(d)(2) relating to the receipt of compensatory fees and affiliation as follows: (1) one member must satisfy the requirements within six months from the Start Date; (2) a majority of members must satisfy the requirements within nine months from the Start Date; and (3) all members must satisfy the requirements within one year from the Start Date.

Since a Smaller Reporting Company is required to have a compensation committee comprised of at least two Independent Directors (as defined in Nasdaq Rule 5605(a)(2)), a company that has ceased to be a Smaller Reporting Company may not use the phase-in schedule for the minimum size requirement or the requirement that the committee consist only of Independent Directors. During the phase-in schedule, a company that has ceased to be a Smaller Reporting Company must continue to comply with the requirement to have a compensation committee comprised of at least two Independent Directors.

IV. Form of Certification Provided

Included in the partial amendment filing is the form of compensation committee certification Nasdaq intends to use for companies listed on The NASDAQ Stock Market. The actual form will be available through Nasdaq's Listing Center website prior to the effective date of the amended rule.

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[4] Within six months from the Start Date, such a company also must certify to Nasdaq that: (i) it has complied with the requirement in Nasdaq Listing Rule 5605(d)(1) to have a compensation committee charter including the content specified in Nasdaq Listing Rule 5605(d)(1)(A)-(D); and (ii) it has complied, or will within the applicable phase-in schedule comply, with the requirement in Nasdaq Listing Rule 5605(d)(2) regarding compensation committee composition.

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If you have any questions about the issues addressed in this memorandum or if you would like any of the materials mentioned, please do not hesitate to call or email Charles A. Gillman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster at jschuster@cahill.com.