

Nasdaq Proposes to Amend its Listing Rules Regarding Independence of Compensation Committee Members

The NASDAQ Stock Market LLC (“Nasdaq”) recently filed with the Securities and Exchange Commission (“SEC”) a proposed rule change to amend its listing rules implementing Rule 10C-1 of the Securities Exchange Act of 1934 (“Exchange Act”), regarding the independence of compensation committee members (the “Proposed Rule”).¹ The Proposed Rule would replace the current prohibition on the receipt of compensatory fees by compensation committee members with a requirement that a company’s board of directors consider such fees paid by the company, in aggregate with all other sources of compensation of the director, when determining whether he or she is “independent” for purposes of eligibility for compensation committee membership.²

Nasdaq stated that it issued the Proposed Rule in response to feedback that the prohibition on compensatory fees creates a burden on issuers, particularly those in certain industries, such as energy or banking, where it is common to have directors who do a de minimis amount of business with the issuer. The concern was that this additional burden could influence a company’s choice of listing venue. The Proposed Rule would also make Nasdaq’s listing rules consistent with the New York Stock Exchange’s listing standards.

Even under the Proposed Rule, a compensation committee member would not be allowed to receive unlimited fees from a company, however, because the definition of “Independent Director” under the Nasdaq Listing Rules excludes any director who: (i) accepted any compensation from the company in excess of \$120,000 (other than for board or board committee service) during any period of twelve consecutive months within the prior three years; or (ii) 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 fiscal years that exceed 5% of the recipient’s consolidated gross revenues for that year, or \$200,000, whichever is more.³

Consistent with the mandates of Rule 10C-1, the current Nasdaq listing rules require boards of directors to consider affiliation in determining compensation committee membership. The Proposed Rule would make minor wording changes to Rule 5605(d)(2)(A) to make the “affiliation” prong clearer. Specifically, the Proposed Rule would add language to Rule 5605(d)(2)(A) 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 which is material to that director’s ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to, whether such director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary.⁴ The Proposed Rule would also add language to IM-5605-6 stating that when considering any affiliate relationship a director has with the company, a subsidiary, or an affiliate of a subsidiary, in determining independence for purposes of compensation committee service, the board should

¹ See SR-NASDAQ-2013-147, available at <http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2013/SR-NASDAQ-2013-147.pdf>. The Proposed Rule would amend Nasdaq Listing Rule 5605(d)(2)(A) and IM-5605-6.

² For purposes of the affirmative independence determination described in the Proposed Rule, any reference to the term “company” would also include any parent or subsidiary of the company.

³ “Independent Director” is defined in Nasdaq Listing Rule 5605(a)(2). Although compensation for board or board committee service is excluded from the \$120,000 cap, the board must still consider such compensation for purposes of affirmatively determining the independence of any director who will serve on the compensation committee.

⁴ As noted in the Proposed Rule, Nasdaq does not believe that this modification would constitute a substantive change from the existing rule which requires compensation committee members to be Independent Directors, and, by definition, have no relationship with the company that would interfere with the exercise of independent judgment.

CAHILL

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.

Nasdaq is seeking comments on the Proposed Rule. The comment period will last 21 days from the date of publication in the Federal Register. Nasdaq has already approved the Proposed Rule, however, and, barring any action by the SEC to suspend or disapprove it, listed companies must begin complying with the Proposed Rule, as with all other listing standards regarding enhanced independence requirements under Listing Rule 5605(d), by the earlier of their first annual meeting after January 15, 2014, or October 31, 2014 (the "Final Implementation Deadline").⁵ Listed companies will also be required to certify compliance with the Proposed Rule, as with the other enhanced independence requirements of Listing Rule 5605(d), no later than 30 days after the applicable Final Implementation Deadline in 2014. The certification form for compliance with the enhanced independence requirements of Listing Rule 5605(d) is expected to be available on Nasdaq's Listing Center website no later than January 15, 2014.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman 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@cahill.com; Glenn Waldrip at 212-701-3110 or gwaldrip@cahill.com; or Abigail Darwin at 212.701.3240 or adarwin@cahill.com.

⁵ The SEC may summarily suspend the Proposed Rule within 60 days of filing if it appears to the SEC that such action is: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Exchange Act. If the SEC were to suspend the Proposed Rule, it would then be required to institute proceedings to determine whether the Proposed Rule should be approved or disapproved.

This memorandum is for general information purposes only and is not intended to advertise our services, solicit clients or represent our legal advice.