ABA Business Law Section
AMERICAN BAR ASSOCIATION

321 North Clark Street
Chicago, IL 60654
(312) 988-5588
Fax: (312)988-5578
www.ababusinesslaw.org
businesslaw@abanet.org

ASSOCIATION YEAR 2010-2011

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Exchange Place
53 State Street
Boston, MA 02109

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P.O. Box 3528
721 North Cincinnati Street
Spokane, WA 99220

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Washington, DC 20006

SECRETARY
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Suite 800
1001 Pennsylvania Avenue, NW
Washington, DC 20004

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Warren, OH 44484

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SECTION DIRECTOR
Susan Daly Tobias
Chicago, IL
(312) 988-6244
suedaly@staff.abanet.org

June 29, 2011

<u>Via Email: rule-comments@sec.gov</u>

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attention: Ms. Elizabeth M. Murphy, Secretary

Re: File No. S7-13-11
Rel. Nos. 33-9199; 34-64149
Listing Standards for Compensation Committees

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "***Committee***" or "***we***") of the Business Law Section (the "***Section***") of the American Bar Association (the "***ABA***") in response to the request for comments by the Securities and Exchange Commission (the "***Commission***") in the proposing release referenced above (the "***Proposing Release***"). In the Proposing Release, the Commission has proposed rules (the "***Proposed Rules***") for implementing Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "***Dodd-Frank Act***"), which adds a new Section 10C ("***Section 10C***") to the Securities Exchange Act of 1934 (the "***Exchange Act***"). Section 10C requires the Commission to direct the national securities exchanges to establish and enforce listing standards for independent compensation committee members, and it addresses the authority of board compensation committees to select and retain compensation consultants, legal counsel and other advisers. In addition, Section 10C requires the Commission to adopt new disclosure rules concerning the use of compensation consultants and conflicts of interest.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the Section.

I. Overview

The Committee supports the general approach taken in the Proposing Release with respect to the implementation of Section 10C. Specifically, we agree with the Commission's proposal to permit each national securities exchange to establish its own rules regarding compensation committee independence tailored to that exchange's listed companies.

II. Compensation Committee Independence

A. We concur with the provisions of the Proposing Release that would not require listed companies to have compensation committees.

The Proposing Release notes that while Section 10C requires that "board committees that set compensation policy will consist only of directors who are independent," Section 10C does not require that a listed issuer have a compensation committee or a committee that performs functions typically assigned to a compensation committee.[1] Nor does Section 10C require that the compensation of executives be approved by a compensation committee.

The Proposed Rules do not mandate a national securities exchange to require a listed issuer to establish a compensation committee. Rather, Proposed Rule 10C-1 directs the exchanges to adopt listing standards that would be applicable to any committee of the board of a listed company that oversees executive compensation, whether or not the committee performs other functions and whether the committee is formally designated as a compensation committee. Proposed Rule 10C-1(b) would not require the listing standards to apply to independent directors who oversee executive compensation in lieu of a board committee, because Section 10C refers only to compensation committees. We agree with the Commission that the scope of the rules should apply only to compensation committees created by listed companies, and should not mandate either the creation of compensation committees or impose standards on companies that, in accordance with stock exchange listing standards, have provided for compensation decisions to be made by a majority of the independent directors. By allowing alternative approaches, the exchanges have permitted flexibility in the manner in which companies may make compensation determinations.[2]

Proposed Rule 10C-1(b) would maintain this flexibility. Many issuers do not have a large numbers of independent directors yet are required or deem it advisable to have several standing committees or groupings of directors composed entirely of independent directors. These responsibilities may impose considerable burdens on independent directors. Permitting a listed company to determine how its board will oversee executive compensation will enable the company to reduce costs and resource burdens and achieve an appropriate balance in the workloads borne by their independent directors.

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[1] See Section II.A.1 of the Proposing Release.

[2] For example, as the Commission also notes in Section II.A.1 of the Proposing Release, the New York Stock Exchange ("***NYSE***") generally requires a listed issuer to have a compensation committee composed solely of independent directors to oversee executive compensation (see NYSE Listed Company Manual Section 303A.05), while the NASDAQ Stock Market ("***Nasdaq***") requires that executive compensation be determined or recommended to the board for determination 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 (see Nasdaq Rule 5605(d)).

B. We concur with the provisions of the Proposing Release that would not impose the obligations of Section 10C on companies without compensation committees.

We do not believe that the new rules should apply to independent directors who, in the absence of a compensation committee (or another committee that oversees executive compensation), determine, or recommend to the board of directors for determination, executive compensation matters of a listed issuer. Section 10C does not clearly mandate the application of the provisions of that section to groups of independent directors that do not consist of formal committees responsible for executive compensation determinations, and we do not believe such an application should be necessary. As a practical matter, we understand that most listed companies that are accelerated filers under the Exchange Act, and many listed companies that are smaller reporting companies, already have compensation committees or committees performing the functions of compensation committees. We see no significant need to expand the application of the proposed rules to listed companies that do not have compensation committees. Such an extension would impose additional burdens on such companies, without necessarily improving their performance of their compensation oversight.

C. The final rules should clarify that the compensation committee independence standards apply only to the board committee that oversees executive compensation.

Section 10C-1(b) of the Exchange Act directs national securities exchanges to establish and enforce listing standards applicable to members of compensation committees. In our view, it is clear from the language of the Dodd-Frank Act and its legislative history [3] that Section 10C was intended to apply only to executive compensation. As the Commission notes on page 9 of the Proposing Release, Proposed Rule 10C-1(b) "would direct the exchanges to adopt listing standards that would be applicable to any committee of the board that oversees executive compensation."

We believe the language of Proposed Rule 10C-1(b) applying the listing standards to a committee of the board "performing functions typically performed by a compensation committee" could lead to confusion over the scope of the rule. We encourage the Commission to state clearly in its final rules that the listing standards for compensation committee independence to be adopted by the exchanges will apply only to a board committee that oversees executive compensation and will not apply to a committee that determines the compensation of persons who are not executive officers, including non-employee directors, if that committee is different from the company's compensation committee. Likewise, practice varies widely as to whether boards delegate to a compensation committee or to another committee the responsibility for

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[3] *See* H.R. Rep. No. 111-517, Joint Explanatory Statement of the Committee of Conference, Title IX, Subtitle E "Accountability and Executive Compensation," at 72-873 (2010) (Conf. Rep.) ("*Subtitle E—Accountability and Executive Compensation* is designed to address shareholder rights and executive compensation practices.. . . . [U]nder this subtitle, (i) board committees that set compensation policy will consist only of directors who are independent").

determining or overseeing non-executive officer compensation, the responsibility for succession planning, or the responsibility for oversight of risks associated with compensation programs. Clarifying the scope of the listing standard will avoid confusion and uncertainty over the applicability of the standard and will avoid unnecessarily influencing boards' determinations of how best to delegate among its committees various responsibilities.

For similar reasons, we believe that the Commission should clarify in the final rules that the listing standards for compensation committee independence do not apply to a board committee that oversees broad-based employee compensation or benefit plans in which executive officers may also participate, if that committee is different from the compensation committee. We believe this clarification is necessary because boards often delegate responsibility for administering broad-based plans, such as 401(k) plans, to an employee benefits or human resources committee. We believe that the extension of the rules to such other committees, in the context of broad-based benefits programs, would inappropriately constrain the operation of such committees.

D. The final rules should continue to permit each exchange to establish its own independence criteria, provided that the exchange considers the relevant factors specified in Section 10C.

Proposed Rule 10C-1(b)(1) directs the exchanges to determine the definition of independence applicable to compensation committee members after considering relevant factors, including, but not limited to (1) the source of a director's compensation, including any consulting, advisory or other compensatory fee paid by the company to the director; and (2) whether a director is affiliated with the company, a subsidiary of the company or an affiliate of a subsidiary of the company. The Proposed Rule does not specify any additional mandatory considerations for the exchanges' definitions of independence. Accordingly, under the Proposed Rules, each exchange will be permitted to establish its own independence criteria, provided the exchange considers the relevant factors specified in Section 10C relating to sources of compensation and affiliate relationships.

We support the position, expressed in the Proposed Rules, that the exchanges be entitled to adopt the independence criteria they consider to be appropriate. The Proposed Rules permit each exchange to develop more finely tuned rules that reflect the particular characteristics of its respective listed companies. The type, scale and maturity of companies listed on an exchange will vary among exchanges in a meaningful way. For example, companies listed on certain exchanges may be smaller than listed companies on other exchanges, may be less seasoned, and may be more weighted to certain industries, such as technology. Based on information we have reviewed, the average board size of an S&P 100 company (which are primarily listed on the NYSE) is approximately 50% larger than the average board size of a Silicon Valley 150 company (which are primarily listed on Nasdaq). Even within the NYSE, there are meaningful differences in the characteristics of big board and ARCA listed companies. Investors in these disparate categories of companies have meaningfully different expectations and interests in the governance context. Moreover, the needs of the companies and the interests of their shareholders for continuity of board membership and ability to attract board members at reasonable cost may vary significantly. For example, it is substantially easier for the largest, most well known companies on NYSE to attract independent board members than for smaller, recently public Nasdaq companies, and the costs of attracting independent directors, relative to the size of the companies, also differ significantly. These factors have led the exchanges to formulate independence criteria that are consistent with the needs of the companies listed on that exchange. For similar reasons, we also believe that the Proposed Rules correctly do not specify additional factors that the exchanges must consider in developing compensation committee independence standards beyond those set forth in Section 10C.

E. Directors affiliated with large shareholders should not, per se, be precluded from being deemed to be independent.

The Proposed Rules require the exchanges, in connection with the development of listing standards relating to compensation committees, to consider independence factors related to current affiliate relationships between the issuer and the compensation committee member. Section 10C(a)(3)(B) does not, however, specifically preclude directors affiliated with large shareholders, from being deemed to be independent.[4] While the intent of Section 10C(a)(3)(B) is to ensure that compensation committee members do not have relationships with a company's management that would compromise their objectivity in determining the compensation of executive officers, we do not believe that there is a substantial risk that a director's affiliation with a large shareholder precludes such objectivity in the compensation context. In fact, a director affiliated with a large shareholder may have a significant interest in assuring that the compensation of executive officers of its investees is fair and reasonable, and may also have the perspective and the resources necessary to evaluate such fairness and reasonableness. For example, the boards of small or newer public companies that have been financed, prior to the time they were public, by private equity firms and venture capital firms often have persons affiliated with those firms on their boards. It would, in our view, not be in the interests of the shareholders of the public companies to deprive the compensation committees of such companies of the experience of such directors.

The general thrust of compensation related governance over the past decade has been to allow all shareholders to have a voice in compensation decision making. Historically, private equity and venture capital investors have been at the forefront of aligning pay with performance and imposing strict compensation oversight. This trend to giving all shareholders a voice has culminated in the "say on pay" provisions of the Dodd Frank Act. The elimination of large shareholders from direct participation in compensation decision making would be counter to the

[4] Section 10C(a)(3)(B) is similar in many respects to Section 10A(m)(3)(B) of the Exchange Act, which provides that each member of the audit committee shall be independent. Section 10A(m)(3)(B) elaborates on the criteria for audit committee independence by providing that a member of an audit committee "may not" be "an affiliated person of the issuer or any subsidiary thereof." Rule 10A-3(e) defines "affiliate" to include both a person controlling the registrant and any executive officer or employee of an affiliate. As a result, employees of controlling shareholders cannot serve on the audit committee of a controlled corporation. This latter provision has not been carried forward in Section 10C(a)(3)(B).

basic rationale for "say on pay"—that shareholders should have a voice in how executives are compensated. We do not believe such a limitation is warranted.

In summary, we believe the Commission should clarify in the final rules that directors who may be affiliates of large shareholders of a listed company should not be per-se disqualified from being deemed to be independent for purposes of serving on a compensation committee.

F. No "look-back" period should be imposed when considering independence factors.

The final rules should not, in our view, mandate the exchanges to require a look-back period for determining independence of compensation committee members. The general director independence standards of both the NYSE and Nasdaq already include a three-year look-back with respect to the bright-line independence standards. The addition of a look-back period with respect to any independence criteria beyond the general board independence criteria will make it more difficult for companies, particularly smaller companies, to identify directors eligible to serve on their compensation committee, and companies may be reluctant to add to their boards directors who would be disqualified from compensation committee service. The more stringent additional independence criteria adopted for audit committee members pursuant to the Sarbanes-Oxley Act of 2000 do not include a mandatory look-back period. We are not aware of any adverse effects resulting from the lack of a look-back period with respect to these additional criteria. The Dodd-Frank Act provisions regarding additional compensation committee independence criteria are modeled on the Sarbanes-Oxley audit committee provisions and do not mandate a look-back period. We see no need for a look-back period for any additional compensation committee criteria that may be imposed by the exchanges and do not believe the requirements should be more stringent in this regard for compensation committees than for audit committees. Accordingly, we believe the Commission should clarify in the final rules that a look-back period should not be imposed in determining the independence of compensation committee members of listed companies.

III. Retention of Compensation Committee Advisers

A. The final rules should clearly identify the engagements to which the rules apply.

Section 10C(c)(1)(A) addresses a compensation committee's authority to "retain or obtain the advice of a compensation consultant." Section 10C(d)(1) addresses a compensation committee's authority to "retain <u>and</u> obtain the advice of independent legal counsel and other advisers." In light of the clear distinction of the scope of these two provisions, the Commission should not as it has proposed use a single rule to address a compensation committee's relationship with both consultants and legal counsel or other advisers.

Clarity in the Commission's implementation of its statutory authority is important in this context because, as noted in the Proposing Release with respect to the disclosure requirements under Section 10C(c)(2), a compensation committee may "obtain the advice" from a compensation consultant without a formal engagement or client relationship between the compensation committee and the consultant, including situations where the consultant was retained by management. The statutory language of Section 10C(d)(1) is clear that its requirements apply only when a compensation committee has retained independent legal counsel, and likewise the language in Section 10C(b) is clear that the requirement of an independence assessment applies only to an adviser that has been selected by the compensation committee. We believe that Congress' language choice should be respected, and that the rules should not apply to or interfere with a compensation committee's dealings with legal counsel from whom it may obtain advice, but which was not retained or selected by the committee, such as in-house and company counsel. Thus, the proposed language in the second sentence of Rule 10C-1(b)(2) should be clear that the requirement that independent legal counsel and other advisers be subject to the direct oversight of the compensation committee applies only to such counsel and advisors who are specifically and separately retained by the compensation committee.

Section 10C(b) imposes substantive procedural obligations on compensation committees with respect to any compensation consultant, legal counsel or other adviser they "select." To implement the statutory language, we believe that the final rules should clarify that Proposed Rule 10C-1(b)(4) is intended to apply only to legal counsel and other advisers "selected," that is, separately and specifically retained by the compensation committee. We believe the statutory language does not support a more expansive approach to this provision, and that the Commission should not seek to expand the scope of the provision in a manner that would interfere with a compensation committee's routine operation by requiring a committee to consider the specified independence-related factors before consulting with or obtaining advice from in-house counsel or outside counsel retained by the management. Consulting with or obtaining advice from such counsel, who have the most in-depth knowledge of the company's business and its compensation policies and practices, and the responsibility for implementing such policies and practices, is the most efficient way for the committee to understand the range of legal issues and ramifications of any intended actions. For different reasons, we also believe that the requirement for an independence assessment should not apply to compensation consultants who are retained by management even if that consultant's advice is presented to and considered by the compensation committee. Performing an independence assessment where compensation consultants, legal counsel or other advisors do not purport to be and are not held out as independent would be a time-consuming and unnecessary exercise.

B. The final rules should expressly confirm that compensation committees are not required to retain independent counsel.

The Proposing Release clarifies that the statute does not require that compensation committees hire "independent legal counsel," and that the Commission does not construe the statute as "requiring a compensation committee to retain independent legal counsel or as precluding a compensation committee from retaining non-independent legal counsel or obtaining advice from in-house counsel or outside counsel retained by the issuer or management." We support this important clarification and, in order to avoid debate or legal uncertainty over the issue, believe it would be helpful to include this clarification in the rule or in an instruction or note to the rule.

C. Comments on specific independence considerations.

We support the Commission's proposal to identify those factors listed in the statute, as well as any other factors identified in listing standards, as factors to be considered by a compensation committee with respect to any compensation consultant, legal counsel or other adviser that it has retained, and support the manner in which the Commission has proposed to interpret those standards in the rules. We do not believe that it is necessary to address relationships between a member of a compensation committee and either the adviser or the person that employs the adviser. All of the Commission's and stock exchanges' other independence rules are focused on independence from the company and from management, and there is no readily apparent reason to deviate from that standard here, particularly since compensation committee members will themselves be subject to independence standards under the rules. We believe it would be appropriate for the Commission to consider expressly providing for consideration of any business or personal relationship between the person employing the adviser and an executive officer of the issuer, but any such relationship should not create a presumption of a lack of independence, as such a presumption might not be competitively neutral as between consultants with many employees and many subsidiaries and affiliates. Because it is unclear how stock ownership might affect independence of an adviser, we believe it would be helpful to prescribe a bright-line threshold of materiality, for example $50,000 in fair market value or 5,000 shares of the listed company's stock, below which an adviser's stock ownership would not be deemed to affect his or her independence. With respect to other aspects of the enumerated factors, we believe that in order to preserve the ability of compensation committees to conduct facts and circumstances analyses, it is not necessary to further define specific terms.

D. Conforming defined terms.

We note that in proposed Rule 10C-1(b)(4), the Commission (consistent with the statute) uses the term "compensation consultant" to refer to an individual adviser, as distinguished from the person that employs the compensation consultant. In contrast, the Commission's existing and proposed rules under Item 407 of Regulation S-K use the term "compensation consultant" to refer to the person that employs individual advisers. In order to avoid confusion between the terms, we encourage the Commission to use consistent terminology in its rules, for example by using the term "adviser" to refer to the individual in both sets of rules.

IV. Disclosure Regarding Compensation Consultant Conflicts of Interest

Section 10C(c)(2) requires an issuer to provide additional disclosure in any proxy or consent solicitation material for an annual meeting (or a special meeting in lieu of an annual meeting), in accordance with Commission rules, concerning whether the compensation committee has retained or obtained the advice of a compensation consultant and whether the work of the compensation consultant has raised any conflict of interest, and if so, the nature of the conflict and how it is being addressed. While Section 10C(f) requires that the Commission adopt rules directing the exchanges to prohibit the listing of an issuer that is not in compliance with Section 10C (including the disclosure requirement in Section 10C(c)(2)), the Commission has determined to apply the disclosure requirement to all issuers subject to the proxy rules, not just issuers listed on an exchange. As a result, the Commission has proposed amendments to existing disclosure requirements regarding compensation consultants that are included in Item 407 of Regulation S-K.

A. The Commission should reconsider the approach of integrating the disclosure requirements of Section 10C(c)(2) with existing compensation consultant disclosure requirements.

Item 407 of Regulation S-K requires that issuers subject to the Commission's proxy rules provide fulsome disclosure regarding compensation committees and the use of compensation consultants. These disclosure requirements have developed in recognition of the important role that compensation consultants play in the process of determining executive compensation, and in response to concerns expressed over time with regard to the independence of the compensation consultants serving this important role.

To date, the Commission has taken a balanced approach in eliciting disclosure regarding the role and relationship with the compensation consultant in limiting the disclosure requirements to include (1) identifying the compensation consultants that have played "any role in determining or recommending the amount or form of executive and director compensation"; (2) stating whether the compensation consultants were engaged by the compensation committee or any other person; (3) describing the nature and scope of the consultant's assignment and the material elements of any instructions given to the compensation consultants under the engagement; and (4) disclosing the aggregate fees paid to the compensation consultant for advice or recommendations on the amount or form of executive and director compensation and the aggregate fees for additional services if the consultant provided both such services and the amount of fees for additional services exceeded $120,000 during the fiscal year. Item 407 is currently subject to important exclusions, excluding from the disclosure requirement any role that was limited to providing consulting services with respect to broad-based plans that do not discriminate in scope, terms or operation in favor of an issuer's executive officers and directors and that is available to all salaried employees generally, or any role that is limited to providing information that is not customized for a particular issuer or customized based on parameters not developed by the compensation consultant, and about which the compensation consultant does not provide advice.

We do not believe that this disclosure approach, which has developed over the last five years and has focused on those areas of the compensation consultant relationship that have been seen as of most interest to stockholders, should be fundamentally altered by the adoption of Section 10C(c)(2). Rather than "integrate" the Section 10C(c)(2) requirement into the existing requirements in Item 407(e)(3)(iii), we believe that the preferable approach is to adopt, within Item 407, a separate disclosure item eliciting the broad conflicts of interest disclosure contemplated by Section 10C(c)(2), with some modifications to clarify the application of the new requirements.

B. The Commission's proposed integration of Section 10C(c)(2) into Item 407(e) would narrow the disclosure required by Item 407(e)(3)(iii), but only in certain respects.

As proposed, Item 407(e)(3)(iii) would narrow the requirement to disclose information about the engagement, the nature and scope of the assignment and the material elements of instructions or directions given, to only those compensation consultants which the compensation committee has retained, or from which the compensation committee has otherwise obtained advice. Currently, Item 407(e)(3)(iii) disclosure is required when a compensation consultant has served in any role in determining or recommending the amount or form of executive or director compensation (subject to the exclusions referenced above), no matter who had retained such compensation consultant and no matter to whom the advice was provided.

At the same time that the Commission has proposed to narrow that portion of the disclosure requirement, the Commission has proposed to retain the requirement in Item 407(e)(3)(iii) with regard to the disclosure of fees paid for compensation consulting services and additional services in situations where management, rather than the compensation committee, has "retained or obtained" the advice of the compensation consultant. Therefore, it is conceivable under proposed Item 407(e)(3)(iii) that an issuer would be required to provide disclosure regarding fees paid with respect to compensation consulting services provided to the company and its management, without at the same being required to disclose information about the engagement that gave rise to such fees. We believe that this approach could result in incomplete disclosures and may cause confusion for investors in understanding the nature of the consulting relationships for which the fees are disclosed.

C. The disclosure trigger for providing the required compensation consultant disclosure should be retained.

As proposed, Item 407(e)(3)(iii) would have a disclosure trigger that is consistent with the statutory language of Section 10C(c)(2), by referencing whether the compensation committee has "retained or obtained" the advice of a compensation consultant during the registrant's last completed fiscal year. As a result of the integration of the Section 10C(c)(2) requirements into Item 407(e)(iii), the "retained or obtained" trigger would replace the trigger of "any role in determining or recommending the amount or form of executive and director compensation."

The Commission acknowledges that the practical effect of the proposed change would be minimal, because it would be expected that a compensation consultant would be retained, or that the compensation consultant's advice was obtained, in those situations where the compensation consultant played any role in the determination of or recommendations as to the amount or form of executive and director compensation. We agree with the Commission that the statutory language in Section 10C(c)(2) and in existing Item 407(e)(3)(iii) should not necessarily lead to a different disclosure result (at least with respect to advice provided or services retained by the compensation committee) however, rather than conforming the language in Item 407(e)(3)(iii) to the text of Section 10C(c)(2), we believe that the Commission could properly retain the existing disclosure trigger in Item 407(e)(3)(iii) and achieve the same result. In order to avoid any confusion as to the meaning of the trigger based on "any role in determining or recommending the amount or form of executive and director compensation," the Commission could expand the proposed Instruction 1 to Item 407(e)(3)(iii) to clarify that such role would arise pursuant to a relationship in which the compensation consultant was retained or advice was otherwise obtained regarding executive or director compensation.

D. The existing exclusions in Item 407(e)(3)(iii) for consulting on broad-based plans and non-customized data should be retained.

We do not believe that the implementation of Section 10C(c)(2) necessitates the elimination of the exclusions with respect to consulting on broad-based plans and the provision of non-customized data, as contemplated in the proposed amendments to the rule. The Commission previously adopted these exclusions in recognition of the fact that the excluded activities do not represent the types of activities that warrant further explanation to shareholders under any of the circumstances contemplated by Item 407(e)(3)(iii). Moreover, nothing in the Dodd-Frank Act, and nothing that has occurred subsequent to the Commission's adoption of these exclusions, would suggest that the disclosure approach should now be changed. It appears that the elimination of these exclusions from some, but not all, of Item 403(e)(3)(iii) results from the Commission's efforts to integrate the Section 10C(c)(2) requirement, as opposed to including the Section 10C(c)(2) requirement as a separate disclosure requirement, and thus should be considered as a further reason for avoiding the integration approach in favor of a standalone requirement, with the same exclusions being applied with respect to such standalone requirement.

E. The Commission could include the following language in Item 403(e)(3)(iv) rather than integrating the disclosure requirement into existing requirements of Item 403(e)(3)(iii).

If, as suggested above, the Commission were to determine to not revise in its entirety Item 407(e)(3)(iii) to "integrate" the new requirements, and instead include the Section 10C(c)(2) disclosure requirement as a separate item, we believe that the requirements of Section 10C(c)(2) could be fully achieved with the following regulatory text:

> (iv) With regard to any compensation consultant identified in response to Item 407(e)(3)(iii) whom the compensation committee has retained or from whom the compensation committee has obtained advice, disclose whether the work of that compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict has been addressed.

F. The Commission should consider revising the proposed rule to indicate that conflicts of interest are disclosed to the best of the company's knowledge.

Given the breadth of conflicts of interest subject to disclosure as contemplated by the Proposed Rule (as noted in proposed Instruction 2 to Item 407(e)(3), the factors specified in

Proposed Rule 10C-1(b)(4)(i) through (v) would be among the factors to be considered in determining whether a conflict of interest exists), and given the fact that whether a potential conflict of interest exists may in some circumstances be within the particular knowledge of the compensation consulting firm or its personnel, the disclosure requirement should be qualified to the best of the issuer's knowledge. It should be expected that issuers will establish relevant disclosure controls and procedures in order to make determinations as to conflicts of interest that would require disclosure,; however, given the necessary reliance on the information held by the compensation consulting firm and the firm's personnel, an issuer may never be able to say with absolute certainty that all conflicts of interest have been identified for the purposes of the disclosure requirement. For this reason, an appropriate knowledge qualifier should balance the need for fulsome disclosure with the potential burdens of imposing extraordinary due diligence requirements with respect to third parties on the affected issuers.

G. The Commission should consider whether any further guidance could be provided as to the conflicts of interest sought through the disclosure requirement.

We support the Commission's proposed Instruction 2 to Item 407(e)(3), which references as "among other factors" to be disclosed those specific conflict of interest areas identified in Section 10C and to be codified in Proposed Rule 10C-1(b)(4)(i) through (v). The Commission should consider expanding proposed Instruction 2 to Item 407(e)(3) to identify other conflict of interest areas that the Commission believes may need to be disclosed so that issuers can have more complete guidance as to what areas to look for when establishing appropriate disclosure controls and procedures, such as questionnaires for compensation consultants.

We do not believe that it is appropriate for the Commission to expand the Section 10C(c)(2) disclosure requirement to cover both actual and potential conflicts of interest. The statutory language specifically targeted disclosure of conflicts of interest and the steps taken to address such conflicts of interest, without mentioning the notion of a "potential" conflict of interest. As we have noted, we believe that issuers will face particular difficulties in identifying when an actual conflict of interest exists, and we believe that extending the disclosure requirement to include potential conflicts of interest will only exacerbate this concern. We do not believe that potential conflicts of interest, which could be wide-ranging and more difficult to define than actual conflicts of interest, would not provide investors with additional material information regarding the compensation consultant relationship.

H. The disclosure regarding compensation consultant conflicts of interest should only be required in proxy and information statements for meetings at which directors are to be elected.

We support the Commission's proposal to limit the disclosure required by Section 10C(c)(2) to proxy and information statements for meetings at which directors are to be elected. In this regard, we believe that the disclosure concerning compensation consultant conflicts of interest is most appropriately required in the context of other corporate governance disclosures that are most relevant in the context of making voting decisions with respect to the election of directors. We do not believe that such disclosure is necessary in other contexts, and we believe that imposing the disclosure requirements outside of the context of proxy statements and information statements with respect to director elections would unduly burden issuers without any commensurate benefit for shareholders or prospective investors.

I. Controlled companies should be exempted from the disclosure requirement of Section 10C(c)(2).

Consistent with the authority provided to the Commission in Section 10C, we believe that the Commission should consider exempting controlled companies from the requirement to provide the disclosure contemplated by Section 10C(c)(2). In this regard, we believe that given the level of control by a single shareholder or group of shareholders in a typical controlled company situation, the relationships of compensation consultants and conflicts of interest are likely to be of little interest to stockholders in connection with the election of directors.

J. The Commission should not extend the disclosure requirements to cover conflicts of interest for other advisers, such as attorneys.

We do not believe that Section 10C(c)(2) compels the Commission to require disclosure concerning conflicts of interest involving any other advisers to the compensation committee, nor do we believe that other factors should lead the Commission to require disclosure with regard to conflicts of interest involving advisers such as attorneys. In this regard, we believe that the concerns which have led to incrementally more disclosure regarding compensation consultant conflicts of interest likely do not apply in the context of other professionals who may advise the compensation committee. Without an articulated basis for why such additional disclosure should be required, we believe that the Commission should restrict the current rulemaking to the specific mandates of Section 10C(c)(2).

K. We do not believe that additional fee disclosure requirements are appropriate in the context of this rulemaking.

We believe that the Commission's efforts to date for eliciting fee disclosure concerning compensation consultants have struck the right balance in terms of the level of detail and that further detail concerning particular areas, such as revenue concentration, is not warranted at this time.

V. Exclusions and Transition

A. Proposed Rule 10C-b(1) should include a transition period for issuers that have just completed an initial public offering.

The Commission has requested comment as to whether "companies that have just completed initial public offerings [should] be given additional time to comply with the requirements" for compensation committee independence in the same manner that audit committees of initial public offering ("***IPO***") companies are provided with a transition period.

We believe the Commission should provide IPO companies with at least the same additional time to comply with the requirements for compensation committee independence as it has provided for compliance with the requirements for audit committee independence.

B. Smaller reporting companies should be exempted from the application of the compensation committee independence requirements and the new consultant disclosures.

The Commission has requested comment as to whether smaller reporting companies ("***SRCs***") should be provided with an exemption from the proposed new compensation committee independence requirement and consultant disclosures. SRCs typically have fewer directors than larger companies and have a much harder time identifying independent directors to serve on their boards. In addition, in our experience, compensation committees of SRCs often do not hire outside compensation consultants, both because the compensation programs of SRCs tend to be relatively simple and because SRCs often cannot afford to hire outside experts. We also note that the additional consultant disclosures would be a significant burden to SRCs. For these reasons, we believe that the Commission should exempt SRCs from both the independence requirements and the consultant disclosures.

If the Commission does not agree that a complete exemption is appropriate for SRCs, a two-year delay would at least give SRCs some time to seek additional directors, if necessary, and to review disclosures made by larger companies with respect to their compensation consultants.

C. Foreign private issuers should be exempted from the application of the compensation committee independence requirements and the consultant disclosures.

Section 10C(a)(1) and Proposed Rule 10C-1(b)(1) exempt foreign private issuers from the compensation committee independence requirements if such issuers provide disclosure in their annual reports to shareholders of the reasons they do not have an independent compensation committee. Foreign private issuers also are not subject to current Rule 407(e)(3)(iii) disclosure and other requirements of the proxy statement disclosure rules. We believe that the adoption of Section 10C should not compel the Commission to take a radically different approach to the treatment of foreign private issuers with respect to corporate governance matters, including executive compensation and the relationship of the company or the compensation committee with a compensation consultant. Accordingly, we recommend that the Commission exempt foreign private issuers from the requirements of Proposed Rules 10C-1(b)(2) through (4).

VI. Additional Comments

A. The Commission should consider revising the definition of non-employee director under Rule 16b-3 to permit directors affiliated with large shareholders to serve on the compensation committee.

Representatives of entities that are "affiliates" of the issuer already face challenges in serving on the compensation committee of the board of directors. Because the compensation committee typically administers the equity incentive plans under which stock awards are made to executives, most issuers elect to populate their compensation committees with directors who qualify as non-employee directors for purposes of Rule 16b-3 under the Exchange Act. Acquisitions and dispositions of equity securities by directors and executive officers that are approved by a committee of two or more non-employee directors are eligible for exemption from liability under Rule 16b-3. Although there are alternative exemptions that are available, most issuers find the non-employee director alternative to be the most convenient and useful.

The definition of non-employee director causes a potential problem for representatives of affiliates of the issuer. A non-employee director may not be someone who is "currently an officer (as defined in Rule 16a-1(f)) of the issuer or a parent or subsidiary of the issuer, or otherwise currently employed by the issuer or a parent or subsidiary of the issuer." (emphasis added.) The definition of parent is found in Rule 12b-2: "a 'parent' of a specified person is an affiliate controlling such person directly or indirectly through one or more intermediaries." An affiliate is, or course, determined by reference to the customary securities law definition as someone who "controls, or is controlled by, or is under common control with, the person specified." Many venture and private equity funds are organized as limited partnerships. Under Rule 16a-1(f), "when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership." Thus, an officer or employee of a venture or private equity fund that is an affiliate of the issuer would not qualify to be a non-employee director for purposes of Rule 16b-3.

We understand that whether or not an entity is an affiliate of an issuer is a facts and circumstances determination as to which there is no numerical or other bright line. Rather than taking the risk that the non-employee director status of one of their fund representative directors will be challenged, however, many issuers either seek to keep these directors off the compensation committee altogether or create special subcommittees under the compensation committee to administer equity plans. For the same reason that representatives of large stockholders should not automatically be considered not to be independent for purposes of the compensation committee independence rules, they should similarly be eligible to serve as non-employee directors for purposes of Rule 16b-3.

The concept of non-employee director was added to the Section 16 rules in 1996 to replace the previous requirement that plans under which awards were made be approved by shareholders. At the time, the Commission stated that it believed that traditional state law procedural protections could be useful as a prophylactic for curbing the insider trading abuses that Section 16 is designed to address. These procedural safeguards typically focus on actions by disinterested directors, which is simply another way of defining independence. We do not believe that stock ownership alone causes a person to fail to be independent under state law, nor should it for securities law purposes.

One way to address the issue would be to add a proviso to the first clause of the non-employee director definition to the effect of the following: "provided, however, that an officer or employee of a parent of an issuer shall not be precluded from being a non-employee director of the issuer by reason of such parent's stockholdings alone." With this proviso, stock ownership alone would not affect the ability of a stockholder or its representative from serving as a non-employee director.

Another way to address the problem would be to scrap the current definition of non-employee director and to allow the concept of compensation committee independence – however it is ultimately determined – to be the standard under Rule 16b-3 as well. We believe that no purpose is served by the proliferation of similar – but slightly different – concepts of independence in the compensation area. There are non-employee directors under Rule 16b-3 and outside directors under Section 162(m) of the Internal Revenue Code, and now there will be independent directors for compensation committee purposes. We believe the Commission should consider using whatever definition of independence is used for compensation committee purposes to serve also as the definition of non-employee director for Rule 16b-3 purposes.

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Once again, the Committee appreciates the opportunity to submit these comments. Members of the Committee are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
Jeffrey W. Rubin
Chair of the Federal Regulation of Securities Committee

Drafting Committee:
Chair: Sue Morgan
Keith Higgins
David Lynn
Ronald Mueller
Gloria Nusbacher
Jeffrey W. Rubin
Scott Spector
Ann Yvonne Walker

cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Luis A. Aguilar, Commissioner
The Hon. Kathleen L. Casey, Commissioner
The Hon. Troy A. Paredes, Commissioner
The Hon. Elisse B. Walter, Commissioner
Meredith Cross, Director, Division of Corporation Finance
Thomas Kim, Chief Counsel, Division of Corporation Finance