UNIVERSITY OF
DENVER
STURM COLLEGE OF LAW

Sent Electronically

October 30, 2012

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE,
Washington, DC 20549-1090

Re: SR-NASDAQ-2012-109; Exchange Act Release No. 68013 (Oct. 9, 2012)

Dear Ms. Murphy:

Please accept this comment on the proposed rule change submitted by Nasdaq that would modify the listing rules for compensation committees and bring them into compliance with Rule 10C-1 under the Exchange Act ("Nasdaq Proposal").

The Nasdaq Proposal contains a number of important and valuable changes. Specifically, the Nasdaq Proposal would require the board of directors of a listed company to create a separate compensation committee with not less than two members. The Proposal also seeks to reduce some of the complexities associated with multiple definitions and standards concerning director independence by imposing the same prohibition on the payment of compensatory fees to directors serving on the audit and the compensation committees. These changes will strengthen the compensation approval process for companies listed on Nasdaq.

The Proposal, however, falls short of the requirements imposed under Section 10C of the Exchange Act and Rule 10C-1 in a number of respects. First, the Proposal does not, as the statute mandates, require boards to consider as a relevant factor the fees paid to the directors for their service on the board or to consider the compensation paid by persons other than the issuer. Second, the Proposal does not require that the board, in determining director independence, take into account personal or business relationships between directors and executive officers. Third, the Proposal provides for exceptions to the independence requirement that go beyond what is permitted in the statute. Finally, the Proposal failed to clarify that any relevant factor, standing alone, could result in a loss of independence.

I. Fees for Service on the Board

Section 10C mandates that the listing rules of the exchanges specify the "relevant factors" that must be considered in determining the independence of directors serving on the compensation committee. The factors must include "the source of compensation of a member of the board of directors of an issuer, including any consulting, advisory, or other compensatory fee paid by the issuer to such member of the board of directors."[1]

Fees paid for service on the board are a form of compensation. *See* Item 402 of Regulation S-K, 17 CFR § 229.402 (providing for disclosure of fees in a table labeled "director compensation). As a result, the broad language of Section 10C requires that these fees be included within the list of relevant factors.

The Nasdaq Proposal, however, declined to require consideration of fees paid to directors for service on the board. As the Proposal explained: "Nasdaq does not believe that the intent of the Dodd-Frank Act or Rule 10C-1 was to limit independence based on director compensation . . ." The Proposal, however, provided no support for the determination. Moreover, the position reflected a misreading of the language of the statute and the intent of Congress.

The Nasdaq Proposal reads the language in Section 10C and Section 10A, the provision dealing with audit committees, as identical. Yet the two provisions are very different. Section 10A *prohibits* a director from serving on the audit committee if he or she accepts "any consulting, advisory, or other compensatory fee from the issuer."[2] Expressed as a prohibition, the "compensatory fee" language did not extend to compensation paid for service on the board. To have done so would have limited membership on the audit committee to unpaid directors.

Early versions of Dodd-Frank sought to use the same approach with respect to the compensation committee. The House version proposed to *prohibit* directors who received "any consulting, advisory, or other compensatory fee from the issuer."[3] As in Section 10A, the language was not intended to extend to compensation paid for service on the board.[4]

The final legislation, however, rejected the House approach. Rather than *prohibit* directors from serving on the compensation committee, Section 10C merely required the board to consider "relevant factors" in determining independence. The weight and significance of each factor was left to the discretion of the board.

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[1] 15 U.S.C. § 78j-3(a)(3)(A).
[2] 15 U.S.C. § 78j-1.
[3] *See* 156 Cong. Rec. H9214 (July 31, 2009).
[4] *See* 156 Cong. Rec. H9214 (July 31, 2009) ("In order to be considered to be independent for purposes of this subsection, a member of a compensation committee of an issuer may not, *other than in his or her capacity as a member of the compensation committee, the board of directors, or any other board committee* accept any consulting, advisory, or other compensatory fee from the issuer.") (emphasis added).

This more flexible approach allowed Congress to expand the types of compensation that had to be considered in determining director independence. Rather than limit consideration to "any consulting, advisory, or other compensatory fee," the approach taken in Section 10A and proposed in the House, Congress broadened the language to include consideration of "the source of compensation of a member of the board of directors of an issuer".

The Nasdaq Proposal gives no effect to this language, thereby reading the phrase out of the statute.[5] The phrase, however, has obvious and significant meaning. The language on its face ("source of compensation") applies to all types of compensation, including compensation paid by any person (including non-issuers) and compensation paid to directors for service on the board. Thus, the Proposal's view that fees paid to directors was not intended by Dodd-Frank to be considered is incorrect and inconsistent with the plain language of Section 10C.

Wholly aside from the mandate of Section 10C, compensation paid to directors in return for service on the board is a relevant factor in determining director independence. Such compensation can, in certain circumstances, impair independence. This is true, for example, where directors' fees are deemed excessive[6] or are paid as a *quid pro quo.*[7] Likewise the method used to determine fees can impair independence. Committee members with excessive discretion over the terms of director compensation may lose their independence.[8] Indeed, the NYSE has recognized that the payment of non-customary fees may impair independence.[9]

The Commission should require that the Nasdaq Proposal give Section 10C its plain meaning and specify that boards must, in determining director independence, consider as a relevant factor the amount paid to directors for service on the board.

II. Personal or Business Relationships

Section 10C specifies two relevant factors that must be considered in determining director independence. Congress, however, also provided that the exchanges "shall consider" other relevant factors. In promulgating Rule 10C-1, the Commission "emphasize[d] that it is important for exchanges to consider other ties between a listed issuer and a director" and suggested that they "might conclude that personal or business relationships between members of the compensation committee and the listed issuer's executive officers should be addressed in the definition of independence."[10]

[5] The Proposal acknowledges that Nasdaq would "continue to exempt board fees from its prohibition on payment of compensatory fees to a compensation committee member." Nothing in Section 10C commands a different approach. Congress only required that fees paid as compensation for service on the board be considered as a "relevant factor." The decision to prohibit some types of payments for directors on the compensation committees is within the discretion of Nasdaq but does not obviate the obligation to include these fees as a relevant factor.
[6] *See Orman v. Cullman*, 794 A.2d 5, 29 n. 62 (Del. Ch. 2002).
[7] *See In re Nat'l Auto Credit S'Holders Litig.*, 2003 Del. Ch. LEXIS 5 (Del. Ch. Jan. 10, 2003).
[8] *See Seinfeld v. Slager*, 2012 Del. Ch. LEXIS 139 (Del. Ch. June 29, 2012).
[9] *See* NYSE Rule 303A.09 Corporate Governance Guidelines ("The board should be aware that questions as to directors' independence may be raised when directors' fees and emoluments exceed what is customary.").
[10] Exchange Act Release No. 67220 (June 20, 2012).

The Nasdaq Proposal, however, rejected this suggestion. In taking this position, the Proposal contained what can only be described as a Delphic explanation.

> As discussed in the "Purpose" section above, Nasdaq reviewed its current and proposed listing rules and concluded that these rules are sufficient to ensure the independence of compensation committee members. Therefore, Nasdaq determined not to propose further independence requirements, other than those discussed above.

There are two possible ways to read this statement. One is that Nasdaq already requires consideration of business or personal relationships with executive management in determining director independence. Yet Nasdaq has never expressly stated that these relationships must be considered. Moreover, confusion appears to exist within the issuer community on the obligation to consider these types of relationships.[11] To the extent that Nasdaq already requires consideration of "business or personal relationships" as a relevant factor in determining director independence, the listing rule should resolve any ambiguity and make the requirement explicit.

Alternatively, the statement in the Proposal can be read to mean that Nasdaq views business or personal relationships as irrelevant in determining director independence. The position is incorrect, in conflict with the position of the NYSE,[12] and inconsistent with the intent of Congress. The legislative history makes it absolutely clear that Congress, in adopting Section 10C, expected personal or business relationships to be explicitly considered in determining director independence. Section 10C was specifically designed to "strengthen" the independence of the compensation committee "from the executives they are rewarding or punishing."[13] Said another way, Congress expected the board to exclude from the committee the "pals and golfing buddies" of management.[14]

The omission of any explicit reference to business or personal relationships is particularly apparent when compared to the list of relevant factors required for consideration of consultants. Compensation committees are specifically instructed to consider "[a]ny business or personal

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[11] *See* http://www.theracetothebottom.org/independent-directors/2010/6/1/the-nyse-and-the-problems-of-director-independence-the-plain.html

[12] The NYSE has apparently taken the position that these relationships are relevant in determining director independence. *See* http://www.theracetothebottom.org/independent-directors/the-nyse-and-the-problems-of-director-independence-the-non-t.html (NYSE official said to have advised "that, in interpreting its rules, the NYSE believes relationships between a director and a member of senior management that are material to either party should be considered by a board of directors in its evaluation of a director's independence.").

[13] Summary, Restoring American Financial Stability Act of 2010, 156 Cong. Rec. 4329 (May 28, 2010), *available at* http://banking.senate.gov/public/_files/RAFSASummary_UpdateMay28revised.pdf ("Standards for listing on an exchange will require that compensation committees include only independent directors and have authority to hire compensation consultants in order to strengthen their independence from the executives they are rewarding or punishing.").

[14] *See* 156 Cong. Rec. S2705-06 (April 27, 2010) (statement by Senator Whitehouse) (noting that requirement for independent directors was designed to "make sure, in particular, that the compensation committees of the board that sets executive pay aren't just the pals and the golfing buddies of the people whose multimillion-dollar pay and bonuses they are approving; to make sure it is independent directors who are on the compensation committee and making those decisions."); *see also* 156 Cong Rec S 2611 (April 26, 2010) (Statement by Senator Whitehouse) (legislation "would ensure that the compensation committees of boards of directors, the ones who are figuring out what the CEOs should be paid, are composed of directors who are independent, who are not tied to the management: No more having your pals and golfing buddies decide how much you should be paid.").

relationship of the compensation consultant, legal counsel, other adviser or the person employing the adviser with an executive officer of the issuer."[15] In other words, the provision identifies the relevant categories of relationships and the relevant category of officers. Having recognized the importance of business and personal relationships in the context of consultants, the Nasdaq Proposal provided no sound basis for the failure to extend the same factor to the determination of director independence.

The SEC should compel changes in the Nasdaq Proposal to clarify that boards must consider "business or personal relationships" between directors and executive officers (or senior management) in determining the independence of those serving on the compensation committee.

III. Exceptional and Limited Exceptions

The Proposal provides that Nasdaq would "retain its existing exception that allows a Company to have a non-Independent Director serve on the compensation committee under exceptional and limited circumstances."[16] The exception would allow the board to insert a non-independent director on the compensation committee where doing so is in "the best interests of the Company and its Shareholders," a vague and ill defined standard. The particular member may not serve for more than two years.

The exception is not authorized by Section 10C. Section 10C mandates that "each member" of the compensation committee be independent.[17] The language does not permit the appointment of a non-independent director for up to two years.[18] Section 10C does contemplate that an independent director can lose his or her status as such and authorizes time for a cure. The concept of a cure does not, however, countenance noncompliance from the outset.

IV. Clarifications

In adopting Rule 10C-1, the SEC indicated that no single factor would determine director independence.[19] The statement correctly notes that the factors should be examined in their totality. The quote, however, suggests that a single relevant factor cannot result in the loss of independence. This is a misreading of the requirement. A director can, for example, lose his or her independence solely because of a material personal or business relationship with the CEO, irrespective of the application of the other factors.

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[15] Rule 10C-1(b)(4)(vi), 17 CFR 240.10C-1(b)(4)(vi).

[16] Exchange Act Release No. 68013 (Oct. 9, 2012).

[17] Section 10C(a)(2).

[18] The two year period apparently applies to the specific director. *See* Exchange Act Release No. 68013 (Oct. 9, 2012) ("A member appointed under this exception may not serve longer than two years. "). Nothing in the provision appears to prevent a non-independent director from being replaced, after two years, with another non-independent director. In other words, as currently phrased, a board could include on the compensation committee a non-independent director indefinitely.

[19] *See* Exchange Act Release No. 67220 (June 20, 2012) (noting that relevant factors contained in Rule 10C-1 "should be considered in their totality and that no one factor should be viewed as a determinative factor of independence.").

The Nasdaq Proposal should clarify that a single factor can result in the loss of independence, a position taken by the NYSE.[20] The Nasdaq Proposal did note that "a director cannot be deemed independent if he or she fails any one of the bright-line prohibitions in Nasdaq Listing Rule 5605(a)(2)." The uncertainty embodied in the Commission's comment did not, however, arise in the context of "bright-line prohibitions." The Commission suggested that no "relevant factor" could, standing alone, result in the loss of independence. The Nasdaq Proposal, therefore, should clarify that a single "relevant factor" could result in a loss of director independence.

V. Conclusion

The Commission should require changes to the Nasdaq Proposal to meet these requirements. Alternatively, the Commission should immediately initiate rulemaking procedures and alter the Nasdaq listing rules to bring them into conformity with Section 10C.

With regards,

Yours truly,

J. Robert Brown, Jr.
Chauncey Wilson Memorial Research Professor of Law
Director, Corporate & Commercial Law Program
University of Denver Sturm College of Law
jbrown@law.du.edu
303-871-6254

[20] *See* Exchange Act Release No. 68011 (Oct. 9, 2012) ("The Exchange does not believe it is necessary to include in the listing standards a statement that a single factor may be sufficiently material to render a director non-independent, as this is clearly the intention of the listing standards as drafted. Section 303A.02(a) in its current form and in its proposed amended form requires the board to consider the materiality of each separate relationship between the director and the listed company or its management.").