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“What keeps you up at night?”

Dodd-Frank law sets new rules for compensation consultants, counsel and other advisers

By Marshall B. Paul and Katayun I. Jaffari

SUMMARY

The Dodd-Frank Wall Street Reform and Consumer Protection Act mandates that the compensation committee of a publicly traded company may select a compensation consultant, legal counsel, or other adviser to the compensation committee only after taking into consideration factors identified by the Securities and Exchange Commission that affect the independence of the consultant, legal counsel or adviser.

The compensation of key executives often increases or decreases (although decreases are rare) based on the expert opinion of a compensation consultant retained by a company's compensation committee.

Compensation committees rely heavily on the advice of these consultants; and a board or a compensation committee can cloak itself in the imprimatur of a compensation consultant's report to avoid liability, even in seemingly egregious cases. For example, in the Delaware case of *Brehm v. Eisnor*, decided in 2000, the Board of Directors of The Walt Disney Company, because of its reliance on a compensation expert, avoided liability for approving an employment contract that provided for payments to the company's former president which were alleged to be worth over \$140,000,000, even though he had been employed by the company for only a year.

In recognition of the importance of the role of compensation consultants, the Dodd-Frank Wall Street Reform and Consumer Protection Act addresses this area by adding new Section 10C to the Securities Exchange Act of 1934, which mandates that the compensation committee of a publicly traded company may select a compensation consultant, legal counsel, or other adviser to the compensation committee only after taking into consideration factors identified by the Securities and Exchange Commission that affect the independence of the consultant, legal counsel or adviser. The factors to be taken into account are intended to be competitively neutral

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among categories of consultants, legal counsel and other advisers and are intended to preserve the ability of compensation committees to retain the services of those persons. The factors must include the following:

- Whether the consultant, counsel or adviser or the employer of the consultant, counsel or adviser provides other services to the publicly traded company
- The amount of fees received from the publicly traded company by the person who employs the compensation consultant, legal counsel, or other adviser, as a percentage of the total revenue of the person who employs the compensation consultant, legal counsel, or other adviser
- The policies and procedures of the person who employs the compensation consultant, legal counsel, or other adviser that are designed to prevent conflicts of interest
- Any business or personal relationship of the compensation consultant, legal counsel, or other adviser with a member of the compensation committee
- Any stock of the issuer owned by the compensation consultant, legal counsel or other adviser

A compensation committee, as a committee of the board, is deemed under Section 10C to have the sole discretion to retain or obtain the advice of a compensation consultant, legal counsel and other adviser. Moreover, the compensation committee, if it engages a consultant, legal counsel, or other adviser, is directly responsible for the appointment, compensation and oversight of the work of the person engaged. However, the Dodd-Frank Law provides that nothing in Section 10C is intended to **require** the compensation committee to implement or act consistently with the advice or the recommendation of the consultant, legal counsel or other adviser.

A publicly traded company is required to provide appropriate funding, as determined by the compensation committee, for the payment of reasonable compensation of the consultant, legal counsel or other adviser.

Section 10C also provides that the SEC shall, by rule, permit a national securities exchange to exempt a category of listed companies from the requirements of Section 10C concerning the selection of independent consultants, counsel and other advisers by a compensation committee, taking into account such things as the potential impact of the Section’s requirements on smaller reporting companies.

In addition, the provisions of Section 10C concerning independence of compensation committee consultants, counsel and advisers do not apply to “controlled companies,” which term refers to companies that are listed on a national securities exchange and that hold an election for the board of directors in which more than fifty percent of the voting power is held by an individual, group or another listed company.

Although well-counseled compensation committees already adhere to practices similar to those described above, counsel, consultants and other advisors will have to develop and implement their own policies and procedures, in accordance with Section 10C, that are designed to prevent conflicts of interest on their part. In addition, all publicly traded companies will have to revisit their practices accordingly.

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