Key Transactional Securities and Public Company Disclosure/Governance Provisions

by Gregg Berman and Manny Rivera

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Bill"), which currently awaits required approval from President Obama, contains several transactional securities law and public company disclosure and corporate governance reforms. The Dodd-Frank Bill was approved by the Senate on July 15,2010. The key provisions are summarized below.

Transactional Securities Law Reforms

- **Revised "accredited investor" net worth test.** Currently, Rule 501(a)(5) under the Securities Act of 1933, as amended (the "Securities Act") enables a natural person to qualify as an "accredited investor" eligible to participate in a private placement under Regulation D if his or her net worth, or joint net worth with his or her spouse, exceeds $1,000,000 at the time of a securities purchase. The Dodd-Frank Bill would change the methodology for computing $1,000,000 of net worth by excluding the value of the individual's or spouses' primary residence. Since many individuals seeking to qualify as accredited investors in private placements rely on the value of their homes in determining their net worth, this change represents a significant tightening of the accredited investor definition. Beginning four years after the enactment of the Dodd-Frank Bill, the Securities and Exchange Commission (the "SEC") would be required to adjust the $1,000,000 net worth threshold from time to time to account for inflation and other economic factors, and could adjust or modify other elements of the accredited investor definition "for the protection of investors, in the public interest, and in light of the economy."

- **Disqualification of Offerings by "Bad Actors" from Regulation D Protections.** The Dodd-Frank Bill would require the SEC to adopt rules to disqualify a private placement under Securities Act Rule 506 (the exemption for limited offers and sales without regard to dollar amount of the offering) from the protections of Regulation D if the offering and sale is made by specified categories of "bad boys," including persons convicted of a felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC, persons subject to a final order of a regulatory body which, among other things, bars the person from engaging in the business of securities, insurance, or banking or constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the prior 10-year period.

- **Additional Short Sale Reforms.** The SEC recently adopted rules to curb abusive short-selling practices. The Dodd-Frank Bill would expressly provide that manipulative short sales of securities is illegal, and require the SEC to issue new enforcement rules and to mandate periodic disclosures of the aggregate amount of the number of short sales of public company securities. Registered brokers or dealers would be required to notify their customers of their right to elect not to permit their fully paid securities to be used in connection with short sales and, if the broker or dealer uses the customer's securities, the broker or dealer would be required to notify the customer that it could receive compensation for lending the customer's securities.

Public Company Disclosure and Corporate Governance Reforms

- **Auditor Attestation Requirement Exemption for Non-Accelerated Filers.** Section 404(b) of the Sarbanes-Oxley Act of 2002 ("SOX") requires public companies to provide an attestation report on management's assessment of internal controls over financial reporting by the company's external auditor. Although the SEC delayed SOX Section 404(b) compliance for non-accelerated filers (including smaller reporting companies) several times, in its final rule issued in October 2009, the SEC required all non-accelerated filers to begin complying with SOX Section 404(b) beginning with their annual reports for fiscal years ending on or after June 15, 2010. The Dodd-Frank Bill would override the SEC's final rule by implementing a permanent exemption from the auditor attestation requirement for non-accelerated filers. The SOX Section 404(a) requirement that public companies disclose management assessments on internal control over financial reporting, however, would remain unchanged. In addition, the SEC would be required to conduct a study on how to reduce SOX 404(b) compliance costs for companies with market capitalizations between $75 million and $250 million.

- **Mandatory Shareholder Say-On-Pay Vote.** The Dodd-Frank Bill would require that proxy statements otherwise required to include executive compensation disclosure under the SEC's regulations, such as annual meeting proxy statements, also include a separate proposal for shareholders to approve the executive compensation described in the proxy statement. The shareholder vote would not (i) be binding on the company's board of directors, (ii) create additional fiduciaries or (iii) override existing decisions of the company or its board of directors. In addition, shareholders could elect to have such a "say-on-pay vote" annually, every other year or every three years.

- **Mandatory Shareholder Say-On-Golden Parachute Vote in the M&A Context.** If a public company seeks shareholder approval of a merger, acquisition, or sale of substantially all of its assets, under the "say-on-golden parachute" provisions of the Dodd-Frank Bill, the person making a proxy solicitation would be required to disclose any "golden parachute" agreements with named executive officers of the company or the acquiror and include in the proxy statement a separate proposal for shareholders to approve the "golden parachute" agreements described in the proxy statement. As in the case of a say-on-pay vote described above, the shareholder say-on-golden parachute vote would be non-binding.

- **"No Compensation For Lies" Clawbacks.** Under SOX Section 304, if a public company "is required to prepare an accounting restatement due to material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws," the company's chief executive officer and chief financial officer are required to reimburse the company for any bonus or other incentive-based or equity-based compensation received, and any profits realized from the sale of the company's securities, during the year following issuance of the original financial report. This clawback applies whether or not these officers were engaged in such misconduct. The "no compensation for lies" provision of the Dodd-Frank Bill would create a new, more expansive clawback remedy by requiring public companies with securities listed on national exchanges to implement and disclose policies for requiring current and former executive officers to repay incentive-based compensation, including equity awards, paid by the company in the three-year period before the accounting restatement. The executive would be obligated to repay the amount of compensation actually received in excess of the compensation that otherwise would have been paid to him or her.

- **Compensation Committee Best Practices To Become Compulsory.** The Dodd-Frank Bill would make mandatory, for U.S. public companies with securities listed on national exchanges, several best practices that many public companies already provide for in their compensation committee charters or otherwise follow. The stock exchanges would be required to adopt new rules requiring that the compensation committees of listed U.S. companies (to the extent required to be formed) be comprised entirely of independent directors. Existing independence standards would be strengthened, including as to independence factors such as the sources of compensation from the company and the extent of the director's affiliation with the company. Compensation committees would be required to hire and oversee compensation consultants, attorneys and other advisors, and to consider SEC-prescribed independence criteria in engaging these advisors. Public companies would be required to make specified disclosures concerning compensation consultant engagements.

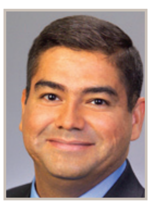
- **New Executive Compensation and Hedging Disclosures.** The Dodd-Frank Bill includes executive compensation disclosure mandates that overlap to some degree with existing disclosure requirements adopted by the SEC in the past few years, but it also identifies several new compensation details to be disclosed. The new disclosures would focus on the relationship between executive compensation and the company's financial performance and pay parity within the company. For example, the Dodd-Frank Bill would require disclosure of the median annual total compensation of all employees other than the chief executive officer and the ratio of the median total annual employee compensation to that of the chief executive officer. In addition, public companies would be required to disclose whether employees or directors are permitted to purchase instruments designed to hedge or offset decreases in the market value of company equity securities that they hold, whether received as compensation or otherwise.

- **Further Prohibitions on Broker Discretionary Voting.** In 2009, New York Stock Exchange Rule 452 was amended to eliminate broker discretionary voting in public company director elections. The Dodd-Frank Bill would also require stock exchanges to prohibit broker discretionary voting in say-on-pay or other executive compensation matters, and in other matters identified as significant by the SEC.

- No Proxy Access Rules or Majority Voting Requirement. The Dodd-Frank Bill does not set forth "proxy access" rules which would require U.S. public companies to include shareholder-submitted director nominees in proxy solicitation materials if specified conditions, such as ownership thresholds, are met. However, the Bill would explicitly affirm the SEC's authority to, but not require the SEC to, promulgate proxy access rules. It is anticipated that the SEC will introduce new proxy access rules in time for the 2011 proxy season. In addition, the Dodd-Frank Bill does not include a provision that would require majority voting in director elections; public companies may, therefore, continue to adhere to a plurality voting standard to the extent their organizational documents do not require majority voting.

The Authors

Gregg Berman
Partner
+1 212 318 3388



Manny Rivera
Sr. Counsel
+1 212 318 3296