

THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: THE IMPACT ON CORPORATE GOVERNANCE AND EXECUTIVE COMPENSATION

President Obama has signed financial reform legislation into law. As reported in our previous Alerts (<http://jaeckle.com/Home/PracticeGroups/CorporateGovernance/Publications>) the Dodd-Frank Act includes provisions that impact corporate governance as well as executive compensation.

Say on Pay

- *Executive Compensation* At least once every three years, proxy materials requiring compensation disclosure must include a resolution seeking shareholder approval of the compensation paid to named executive officers. While the result of this shareholder vote is non-binding, it is anticipated that a "no" vote will impact a company's compensation program. In addition, at least every six years, the company must include in its proxy materials a proposal allowing shareholders to determine whether the say on pay vote will occur every one, two or three years. The first say on pay vote and the first vote on the frequency of say on pay proposals must take place at the first stockholder meeting taking place after January 21, 2011.
- *Golden Parachutes* Proxy materials relating to an acquisition, merger, consolidation, sale or other disposition of all or substantially all of the issuer's assets, must include disclosure describing any agreements or understandings with any named executive officer regarding compensation relating to such transaction. In addition, a resolution seeking a non-binding shareholder vote as to such agreements or understandings and compensation is required. This provision also applies to stockholder meetings taking place after January 21, 2011.

The SEC is provided with the express authority to exempt certain issuers from the say on pay rules if it so determines and may, among other things, consider whether it disproportionately burdens small issuers. The say on pay votes are non-binding, cannot overrule board or company decisions and create no additional fiduciary duty for directors. T

Proxy Access The SEC is given the authority to adopt rules giving shareholders the right to include their own nominees for director in the company's proxy material. However, the bill does not set forth any specific criteria if the SEC adopts proxy access. Most recently in 2009, the SEC proposed rules on this topic.

Compensation Committees

- *Independence* Listing standards will require that each compensation committee member is an independent director. "Independence" will be based on relevant factors including the source of compensation for members and affiliations of the member and is very similar to the independence criteria for audit committee members.
- *Consultants* The compensation committee must have the authority to hire compensation consultants, legal counsel or other advisers and is responsible for the appointment, compensation and oversight of the work of the consultant. The committee must identify

and consider factors affecting independence when hiring such a consultant. These factors include:

- the provision of other services to the issuer by the person that employs the consultant;
- the amount of fees received from the issuer by the person that employs the consultant as a percentage of the total revenue of the employing person;
- the policies and procedures of the employing person that are designed to prevent conflicts of interest;
- any business or personal relationship of the consultant with a member of the compensation committee; and
- any stock of the issuer owned by the consultant.

The issuer will need to disclose in its proxy material (after July 21, 2011) whether a consultant was retained and whether a conflict of interest was raised and, if so, the nature of the conflict and how the conflict is being addressed. The national securities exchanges and associations must implement these listing standards within 360 days after the effective date of the Dodd-Frank Act (July 16, 2011) and may allow for exemptions accounting for, among other things, the impact on smaller reporting issuers.

Clawbacks Listing standards will require companies to implement a clawback policy to recover incentive-based compensation (including stock options) paid to current and former executives based on inaccurate financial statements. In the event a company is required to restate the company's financial statements due to any material noncompliance with any financial reporting requirement under the securities laws, recovery of compensation will be made during the 3-year period preceding the date on which the requirement of an accounting restatement is required. The amount recovered will be the excess of what would have been paid to the executive officer under the accounting restatement.

Disclosure of Pay Versus Performance Proxy materials, in addition to current disclosure, must include disclosure showing the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends and distributions. This disclosure may be presented in a graph. In addition, each company must disclose the median of the annual total compensation of all employees of the issuer (except the chief executive officer), the annual total compensation of the chief executive officer; and the ratio of those amounts. The Dodd-Frank Act does not have a time limit during which the SEC is required to adopt these rules.

Auditor Attestation An exemption from the outside auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act is included for smaller issuers (those with a market capitalization of less than \$75 million). In addition, the SEC is required to study whether such an exemption should be made available to companies with a market capitalization between \$75 million and \$250 million. Results of the study are due to Congress nine months following enactment.

Hedging Activities A company's proxy materials must disclose whether any directors or employees, or any of their designees, are permitted to purchase financial instruments designed to hedge or offset any decrease in the market value of equity securities granted to the director or employee as compensation or otherwise held by such person. There is no time limit on the SEC's adoption of rules relating to hedging policies.

CEO/Chair Disclosure. Disclosure in the proxy materials must be included as to whether and if so, why an issuer has chosen the same person to serve as chairman of the board and chief executive officer (or equivalent position). The SEC has previously issued rules on this topic, and the new legislation is not likely to cause much of a change in those rules.

Voting by Brokers National securities exchanges will prohibit proxy voting by a broker who is not the beneficial owner unless the broker has been specifically instructed to vote the proxy in connection with the election of directors, executive compensation or any other significant matter (as determined by the SEC). Say on pay votes will not be discretionary, and this may cause challenges to some companies in getting sufficient votes.

Action Points:

Many of the corporate governance and executive compensation provisions of the Dodd-Frank Act are subject to further rule making by the SEC and listing exchanges. We will continue to monitor developments as they become available. Here are some actions to consider taking while waiting for additional guidance:

- *Consider the general impact of the Dodd-Frank Act on the company;*
- *Review shareholder communication and investor relationship policies and practices;*
- *Confirm the independence of compensation committee members;*
- *Assess the independence of any compensation consultant; any potential conflicts of interest and review the appropriateness of consultant's fees;*
- *Prepare for say on pay; review compensation policies, practices and disclosures; assess existing compensation arrangements;*
- *Consider the use of clawbacks; review any existing clawback policy or consider the implementation of a policy regarding clawbacks;*
- *Review or prepare policies or practices regarding hedging transactions considering the broad applicability under the Dodd-Frank Act (i.e. employees and directors);*
- *Continue to monitor the SEC and listing exchanges for additional rules and guidance for implementation.*

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