Corporate and Securities News

July 21, 2010

The Financial Reform Bill Is Not Limited to Banks

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Much has been written in the popular press about how the recently passed Wall Street Reform and Consumer Protection Act, a/k/a the "Dodd-Frank Bill" (the "Act"), will prevent future financial market meltdowns and protect consumers from overreaching by large financial institutions. Only time will tell whether those effects will be realized. In the meantime, however, the Act includes a number of provisions that may impact businesses, both large and small, in industries other than banking. Much less attention has been directed to these provisions.

Changes to Definition of "Accredited Investors"

In recent years, most private capital raised in this country to finance businesses in industries as diverse as real estate, manufacturing, healthcare and information technology, among others, has been raised in a manner that is exempt from registration with the SEC and the state securities regulators due to Regulation D. A part of that regulation permits sales of securities to "accredited investors" without complying with burdensome disclosure requirements applicable to limited offerings to other investors The theory underlying the exemption for sales to accredited investors was that these investors were able to afford the investment and could either evaluate the investment for themselves or could afford to retain an advisor to help them in such evaluation.

For years the definition of "accredited investor" for natural persons has included persons whose (i) net worth exceeded $1,000,000, or (ii) whose individual annual income exceeded $200,000 for the last two years and was expected to exceed that amount in the current year, or (iii) whose joint income with their spouse exceeded $300,000 for the last two years and was expected to exceed that amount in the current year.

Under the Act, the first part of this definition has been changed. (Note that the income based tests have not changed.) Beginning with the effective date of the Act (July 21, 2010), in order for a natural person to be an accredited investor based on net worth, the person must have a net worth of $1,000,000, excluding that person's primary residence. In addition, the SEC was charged with reassessing the test every four years, presumably to consider inflation and other factors that might require an adjustment in the net worth test. The effect will be to reduce the universe of potential investors in private offerings of securities for companies in all industries – especially start up and emerging growth companies who most often rely on the Regulation D exemption. Offerings that are "in process" as of the effective date will need to be carefully examined to avoid violation of this new rule.

Enhanced Corporate Governance

For public companies, the Act contains a number of enhanced corporate governance provisions, applicable regardless of whether the company is a financial institution. These governance matters include:

- Mandatory say-on-pay shareholder approval requirements
- Required disclosures relating to pay for performance
- Enhanced compensation committee requirements
- Adoption of "clawback" policies for incentive compensation
- Required shareholder approval for golden parachute compensation
- More restrictive voting by brokers and other nominee holders

Say on Pay

The Act requires a non-binding shareholder vote on the compensation of a company's named executive officers. This provision is similar to the non-binding vote required of banks and other financial institutions that received TARP funding. The vote must occur at least once every three years. The shareholders must determine, at least once each six years, whether the non-binding vote on pay will occur annually, every two years or every three years.

Required Disclosures Relating to Pay for Performance

The Act requires annual disclosure of the relationship between executive compensation and financial performance of the company as well as disclosure of the ratio between the CEO's compensation and the median compensation of all other employees.

Enhanced Compensation Committee Requirements

The Act requires compensation committee members to satisfy independence standards to be established by the applicable stock exchanges. In addition, a compensation committee may

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engage consultants, legal counsel and other advisers only after considering factors, to be promulgated by the SEC, that might affect the independence of such advisers.

Adoption of "Clawback" Policies

The Act expands the compensation clawback provisions currently found in the Sarbanes-Oxley Act by requiring companies to adopt a policy applicable in the event of an accounting restatement due to material noncompliance with financial reporting requirements and providing for the recovery of amounts in excess of what would have been paid under the restated financial statements. The clawback policy must include any current or former executive officer who received incentive compensation (including stock options) during the three-year period preceding the date of the restatement.

Shareholder Approval for Golden Parachute Payments

The Act mandates new disclosures and shareholder approval requirements for golden parachute payments. In connection with a merger or acquisition transaction submitted for shareholder approval, the Act requires disclosure of any compensation arrangement with a named executive officer if the arrangement is based on or related to the transaction, and it requires a non-binding shareholder vote on such compensation unless the compensation was previously covered by a say on pay vote.

Voting by Brokers and Nominees

The Act requires the stock exchanges to prohibit broker discretionary voting in connection with the election of directors, executive compensation or any other significant matters as determined by the SEC.

For more information on the new legislation or how it may affect your company, feel free to contact one of the attorneys in our Corporate and Securities Practice Group.

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