

CORPORATE AND SECURITIES LAW

ALERT

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Significant Changes in Executive Compensation and Corporate Governance: Dodd-Frank Wall Street Reform and Consumer Protection Act Signed into Law

July 21, 2010

Today, July 21, 2010, President Obama signed into law a comprehensive financial regulatory reform bill authored by Senator Christopher Dodd (D-CT) and Representative Barney Frank (D-MA). The legislation, known as the "Dodd-Frank Wall Street Reform and Consumer Protection Act," (the "Act") contains several executive compensation provisions, many of which are incorporated or modified from Senator Dodd's previous bill passed by the Senate on May 20, 2010 (discussed in our [May 26, 2010 client alert](#)). Set forth below are some of these key provisions:

- Shareholder Approval of Executive Compensation ("Say-on-Pay"). The Act requires a non-binding shareholder vote to approve the compensation of executive officers at shareholder meetings for which the SEC requires compensation disclosure. Unlike Senator Dodd's previous bill, shareholders may choose to have a say-on-pay vote every two or three years, as opposed to annually. At least once every six years, companies must provide shareholders with a non-binding vote on whether the say-on-pay votes will occur every one, two or three years. These new requirements apply to shareholder meetings occurring six months or more after enactment of the Act.
- Shareholder Approval of Golden Parachute Compensation. The Act contains new provisions regarding disclosure and shareholder approval of "golden parachute" arrangements with named executive officers. In any proxy statement relating to the approval of an acquisition, merger, consolidation, proposed sale or other disposition of all or substantially all assets, companies must disclose any compensation arrangement with a named executive officer that is based on or otherwise relates to the transaction. Additionally, the Act requires a non-binding shareholder vote to approve any compensation arrangement as disclosed, unless the arrangement was previously subject to a say-on-pay vote. These new requirements apply to shareholder meetings occurring six months or more after enactment of the Act.
- Compensation Committee Independence. Under the Act, compensation committees of all U.S. listed companies must be entirely independent. Furthermore, compensation committees are only permitted to select compensation consultants, legal counsel and other advisers to the compensation committee after considering competitively neutral independence factors determined by the SEC. The Act gives compensation committees the sole discretion and direct responsibility to hire and oversee compensation consultants, legal counsel and other

advisers they retain. Also, companies must provide specific disclosure in their proxy statements regarding whether (i) the compensation committee had retained or received advice from a compensation consultant, and (ii) whether the consultant's work raised any conflict of interest and, if so, how that conflict is being addressed. Notably, the Act has added a new exception from these requirements for controlled companies. The SEC must promulgate rules no later than 360 days after enactment of the Act directing the national security exchanges to prohibit the listing of any issuer that does not comply with these requirements.

- Executive Pay Versus Performance and Additional Disclosures. The Act requires the SEC to amend the proxy statement disclosure rules to require companies to disclose information that demonstrates the relationship between executive compensation that was actually paid and the financial performance of the company. Furthermore, companies must disclose the values and ratio between the CEO's total compensation and the median compensation of all employees (other than the CEO). The Act does not provide a deadline to implement these new rules.
- Recovery of Erroneously Awarded Compensation ("Clawback") Policies. The Act requires companies listed on a national securities exchange to develop, implement and disclose a clawback policy providing that, in the event a company must restate its financials due to material noncompliance of the company with any financial reporting requirement under the securities laws, the company would recover incentive-based compensation (including stock options) from any current or former executive officers in excess of what would have been paid to them under the restated financials for the three-year period preceding the date on which a company is required to prepare the restatement. Notably, this provision applies to all executive officers and is not based on anyone's misconduct - an extension beyond the parameters of the Sarbanes-Oxley Act. The Act does not provide a deadline to implement these new rules.
- Employee/Director Hedging. The Act requires companies to disclose in their annual proxy statements whether they permit any employees or directors to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities granted for compensatory purposes or otherwise held by the individual. The Act does not provide a deadline to implement these new rules.

The Act also contains several corporate governance provisions which will have a significant impact on all public companies.

- Proxy Access. The Act authorizes the SEC to adopt proxy access rules pursuant to which shareholders meeting threshold eligibility requirements could include a certain number of shareholder-designated director nominees in the company's proxy materials. SEC Chairman Mary Shapiro has stated that she expects final proxy access rules to be adopted in time for the 2011 proxy season, and we anticipate that final rules will be adopted sometime this summer. It is likely that public companies will need to review their bylaws related to director nominations for possible amendments to address proxy access once final rules are adopted. We expect that, once adopted, proxy access will significantly increase the number of public companies that are subject to contested director elections initiated by activist shareholders, including multi-shareholder contests. For more information, please see our prior client

alerts dated [March 19, 2010](#), [December 18, 2009](#), [October 6, 2009](#), [July 22, 2009](#) and [June 15, 2009](#).

- **No Majority Voting Requirement.** Unlike the version of the bill that passed the Senate, the Act does not require all U.S. public companies to implement majority voting for the election of directors. This controversial provision would have imposed a federal mandate in an area that has traditionally been determined under state law.
- **Beneficial Ownership Reporting.** The Act amends several provisions of the Securities Exchange Act of 1934 related to disclosure requirements for holders of 5 percent or more of a class of registered voting equity securities. The bill provides that a person may acquire beneficial ownership of a registered class of equity security by the purchase or sale of a security-based swap, as determined by rules to be adopted by the SEC. The SEC is also directed to adopt rules which require monthly disclosure of short positions in registered equity securities. Additionally, the SEC is provided with authority to shorten the reporting period under Section 13(d) or Section 16(a) of the Exchange Act to less than 10 days following an event triggering a reporting obligation.

These corporate governance and executive compensation provisions are part of a more comprehensive financial reform package aimed at bolstering the integrity of the financial markets. We will continue to monitor the implementation of these laws and regulations as the coming proxy season approaches.

Bass, Berry & Sims PLC's Executive Compensation Subgroup is comprised of tax and corporate attorneys who monitor and advise on developments in the tax rules, securities laws and corporate governance standards relating to executive compensation. Bass, Berry & Sims PLC's Shareholder Activism Subgroup monitors and advises on developments in the area of proxy contests, activist campaigns, takeover defenses and shareholder communications. If you have any questions regarding the issues addressed in this *Corporate and Securities Law Alert* or if you would like to set up a meeting with us and your management team or board of directors regarding these developments, please feel free to communicate with your regular contacts in our Corporate and Securities Group or any of the attorneys in our Subgroups listed below.

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The Corporate and Securities Group includes the following subgroups comprised of our attorneys with a particular expertise who are focused on current trends and developments in these areas of the law. This Alert has been brought to you courtesy of the Executive Compensation and Shareholder Activism subgroups.

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