Could financial reform affect your M&A plans?

The recently signed Dodd-Frank Wall Street Reform and Consumer Protection Act is expected to have far-ranging implications — both within and beyond the financial industry. Many believe it will change public company corporate governance significantly, which could in turn affect M&As. Both public companies and private companies planning a deal with a public company should, therefore, review the bill's provisions to understand how it might affect their merger plans.

Indirect consequences

The historic financial reform bill was signed into law in July 2010, but many of its effects won't be known for some time — possibly even years. In many cases, agencies such as the SEC now must hold hearings and draft new regulations based on the Dodd-Frank bill's numerous provisions.

That said, these new regulations, which alter how companies handle issues such as executive compensation, are expected to affect M&A deals. For example, a selling company that has rewarded or plans to reward its executives with "golden parachutes" or similar compensation may need to alter its plans.

"Say on pay," mandated by the new bill, requires public companies preparing for sale in a year or two to establish a good relationship with its shareholders by submitting compensation of executive officers to a shareholder vote. Although the vote is nonbinding, a vote against compensation will become public record and could pose public relations problems for the company. What's more, if the vote isn't accepted by a company's board, it could create a more adversarial relationship between shareholders and management.

"Erroneous compensation" landmines

Another part of the Dodd-Frank bill, Section 954, requires the SEC to direct market exchanges and national securities associations to ensure that the public companies they list implement a new disclosure policy regarding executive compensation, among other items. Companies guilty of "material noncompliance … with any financial reporting" would need to make accounting restatements. They also may be forced to "claw back" or recover from current or former executives any incentive-related compensation based on erroneous data, such as compensatory stock options.

Clawbacks would apply to a three-year period preceding the restatement. However, it's still unclear how companies would need to calculate the amount of the clawback. For potential business sellers, this provision of the bill could be a deal-killer, because clawbacks typically involve long, costly legal entanglements with the compensated executives.

Should you hurry up?

The SEC has only started to issue rulings based on the Dodd-Frank bill's provisions, and it could take months before the agency has sorted out all of the regulations. If your company is planning a deal, it might be wise to get it underway sooner rather than later. But before moving up your timeline, be sure to discuss all facets of the transaction with your M&A advisors. Many issues factor into the timing of an M&A; government regulations are only one piece of a complicated picture.