

# Comp Talks

## The Latest re Director Compensation Litigation

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- Why are we talking about director compensation litigation? And shareholder ratification of director compensation?
- Who is likely to be targeted?
- What is everyone else doing?
- What should we do now?
- What practical issues do we need to consider?
- What other best practices for making and disclosing director compensation decisions should we consider?

# Why Are We Talking About This?

- Plaintiffs' firms are still focused on compensation/proxy matters
- Shareholder derivative litigation is risky, expensive and distracting
- Generally no business judgment protection for directors setting their own compensation
- Case law highlights the benefit of shareholder ratification and importance of a meaningful limit
- Litigation risk + market trends = appropriate for board discussion

# Shareholder Derivative Lawsuits

- ▶ Director compensation likely to be challenged with derivative lawsuit
  - ▶ Shareholder sues directors *on behalf of the company*
  - ▶ Shareholder can file and control litigation if:
    - ▶ Pre-litigation demand served on board, OR
    - ▶ Demand would be futile

# Shareholder Derivative Lawsuits

- ▶ Demand is futile if a majority of the board is interested in the challenged transaction or lacks independence
- ▶ Because non-employee directors approve their own compensation, they are interested as a matter of law
- ▶ Demand is almost always futile in these circumstances and litigation can proceed

# What Is Business Judgment Rule Protection?

- Rebuttable presumption in favor of directors' decisions
- Does not apply in self-dealing transactions (**such as setting own compensation**)
- Can overcome self-dealing in director compensation context only by submitting plan for shareholder ratification

# Why Consider Shareholder Ratification?

- Without shareholder ratification, **burden is on directors to show entire fairness**
- With ratification, burden shifts and shareholder must show
  - Bad faith or intentional misconduct
  - Waste – i.e., so one-sided that no business person of ordinary, sound judgment could conclude that the corporation received adequate consideration
  - Incomplete disclosure

- In *Seinfeld v. Slager* (Republic Services, June 2012), business judgment rule did not apply to large equity grant directors granted to themselves (RSUs with grant date value of \$743K in year 1 and \$215K in year 2)
- The court ruled that the equity plan did not provide “meaningful limits” on the maximum award that could be granted to a director and applied “entire fairness” standard of review
  - Plan contained “limit” of ~\$21.6M per person per year
  - In *Calma v. Templeton* (Citrix, April 2015), the court ruled that the 1M share “limit” in the plan (worth \$55M at time of grant) was not meaningful



# What Did We Learn From *Sienfeld*?

- Ratification is not a “blank check”
- New standard to avoid liability:
  - Awards under shareholder-approved plan;
  - Plan has sufficiently-defined terms; and
  - Plan must impose ***meaningful*** limit on director compensation

# Who Is Likely to Be Targeted?

- Considerations:
  - Director pay relative to peers
  - Aspirational peer group
  - Company performance
  - Industry
  - BUT: all plaintiffs' firms really need is a plaintiff

# Who Is Likely to Be Targeted?

- Myths:
  - My company is too small to be on plaintiffs' firms radars (e.g., Imation with market cap ~\$50M)
  - We haven't increased director compensation lately and so we aren't at risk (e.g., Citrix where total director comp decreased year over year)
  - Our director compensation is relatively modest and so we aren't at risk (e.g., Facebook with a market cap of ~\$297B and director grants averaging \$461K)
  - We haven't been sued yet and so we're probably safe (e.g., SolarCity Corporation sued in September 2015)

# What Is Everyone Else Doing?

- Cooley market data based on review of Russell 3000 proxies filed for annual meetings between January 1, 2015 and June 30, 2015
- ~660 equity plan proposals during this period
- No proposal submitted solely to seek SH ratification of limit on director compensation
- ~33% (222) of equity plans contained some form of limit on director compensation

# What Is Everyone Else Doing?

- ~97% (216) of limits applied only to awards granted under the plan (primarily shares)
  - ~53% (114) of these limits expressed as share limit
  - ~46% (100) of these limits expressed as dollar value limit
- Only ~2% of limits applied to all director compensation (stock and cash whether or not granted under plan)
- No disclosure about how/why particular limits chosen

# Does Market Data Define a “Meaningful” Limit?

- Share limits compared to the biggest award granted to a director in the prior year
  - 25th percentile: 2.9x
  - Median: 5x
  - 75th percentile: 10x

# What Should We Do Now?

- Everyone
  - Educate your board of directors
  - Pay special attention to director compensation disclosure in 2016 proxy statement
- Companies anticipating 2016 equity plan proposals
  - Consider including meaningful limit on director compensation – discuss pros and cons
  - Start discussing form of limit and what's meaningful
- Companies not anticipating 2016 equity plan proposals
  - Consider equity plan solely for shareholder ratification of meaningful limit (similar to a Section 162(m) proposal)
  - No 2015 precedent for this approach

# What Are the Practical Issues?

- What is a “meaningful” limit and yet leaves appropriate future flexibility?
- What does the limit cover?
- How is the limit expressed?
- Should we specify exceptions to the limit?
- How often will we seek reapproval of the limit?
- Should we specify current annual director compensation in shareholder-approved plan document?



**“Limitation on Non-Employee Director Compensation.** The aggregate value of all compensation paid or granted, as applicable, to any individual for service as a Non-Employee Director with respect to any calendar year, including Awards granted and cash fees paid by the Company to such Non-Employee Director, shall not exceed (i) \$[\_\_\_\_\_] in total value or (ii) in the event such Non-Employee Director is first appointed or elected to the Board during such calendar year, \$[\_\_\_\_\_] in total value, in each case calculating the value of any Awards based on the grant date fair value of such Awards for financial reporting purposes. The Board may make exceptions to the applicable limit in this Section 3(e) for individual Non-Employee Directors in extraordinary circumstances, as Board may determine in its discretion, provided that the Non-Employee Director receiving such additional compensation may not participate in the decision to award such compensation or in other compensation decisions involving Non-Employee Directors.”

# What Other Best Practices re Director Compensation Should We Consider?

- Process
- Frequency
- Disclosure
- Stockholder engagement