

The background of the slide is a blurred image of a financial market data screen. It features several rows of data with green numbers and green upward-pointing arrows, indicating stock price increases. The numbers are partially legible, showing values like 19,194.00, 7,997.00, and 206.12. To the right, there are green plus signs followed by values such as +127.11, +133.00, +165.78, and +230.00. The overall color scheme is dark with green highlights.

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# **PUBLIC COMPANY ACADEMY**

# **SHAREHOLDER APPROVAL OF EQUITY PLANS**

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## Overview of Topics

- Approval Requirements
- ISS and Glass Lewis Considerations
- Best Practices (Developments and Litigation)

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# APPROVAL REQUIREMENTS

## Why Do You Need Shareholder Approval?

- SEC Requirements
- Exchange Rules (NYSE and Nasdaq)
  - Generally any material amendment or revision to a plan
- Section 162(m) Approval
  - Generally every 5 years
- Section 422 Approval
  - Within 12 months

## SEC Rules-Item 10 of Schedule 14A

- Item 10. Compensation Plans
  - Sets forth the proxy statement disclosure requirements when action is to be taken at a meeting of shareholders with respect to any plan pursuant to which cash or noncash compensation may be paid
- Any action at a shareholder meeting on any compensation plan, broadly defined to pick up equity, pension, or cash plans
- Briefly describe the material features of the plan
- Identify each class of persons eligible to participate in the plan and indicate approximate number of persons in each class and basis for participation

## New Plan Benefits Table

- Who do you include?
  - Named Executive Officers: Each person (stating name and position) specified in paragraph (a)(3) of Item 402 of Regulation S-K (includes CFO);
  - All current executive officers as a group (Section 16);
  - All current directors who are not executive officers as a group; and
  - All employees, including all current officers who are not executive officers, as a group.

## Specific Grant Information Required For Option Plans

- Specific grant information required for any plan containing options, warrants or other rights:
  - The title and amount of securities underlying such options, warrants or rights;
  - The prices, expiration dates and other material conditions upon which the options, warrants or rights may be exercised;
  - The consideration received or to be received by the registrant or subsidiary for the granting or extension of the options, warrants or rights (does not apply to new plan because no grants to report)
  - The market value of the securities underlying the options, warrants or rights as of the latest practicable date;
  - In the case of options, the federal income tax consequences of the issuance and exercise of such options to the recipient and the registrant; and
  - All New Plan Benefits Table information-no dollar value for options (i.e. Black-Scholes)

## Key Instructions

- Plan is broadly defined to include typical equity plans, cash bonus plans and pension plans.
- If action taken regarding plan, describe material terms of plan; If action taken regarding amendment or amendment and restatement, indicate differences from existing plan.
- File copy of plan with SEC as an Appendix (helpful to state that summary is qualified by actual plan).



## Other Considerations: CDI's and Informal Guidance

- Not required to provide “pro forma” presentation for discretionary awards.
- “Market value of the securities underlying the options, warrants or rights as of the latest practicable date” may be presented as either: (i) market price per share or (ii) aggregate market value of the total number of shares underlying all options.
- Can bundle Multiple Changes (162(m), additional shares, etc.) (CDI 101.03).
- Still need Equity Compensation Plan Information Table and related disclosure under Item 201(d) of Regulations S-K.
  - May want to cross-reference in discussion New Plan Benefits Table disclosure.
  - Proposed Plan or amendment is not included in this table

## Understand that Proposal is Selling Plan to Shareholders

- Focus on the how, what, and why of the plan proposals, and the impact to shareholders.
  - Why is the Plan or amendment being proposed?
  - How did the board determine the number of shares authorized or to be added to the plan?
  - What is the potential value and/or the cost of issuance of the authorized shares/shares to be added to the plan?
  - What is the company's historical burn rate under the existing or predecessor equity plan?
  - What is the dilutive impact on shareholders of the shares authorized or to be added to the plan?
  - How will the company use the shares and how long does the company expect the new shares to last?

## General Recommendations

- Carefully draft SEC disclosures to ensure they provide a fair summary of material information and explain rationale behind board/committee decisions.
- Coordinate all teams responsible for proxy to make sure numbers used in plan proposal section and other parts of the proxy are properly aligned and disclosures reflect actual practice. Inconsistencies are common.
- Refer to the CD&A discussion and NEO tables for past and current grant practices.
- Clearly cross reference attached plan and CD&A.

## Other Recommendations

- Provide more detailed disclosure than required by SEC rules, especially on the who, what, and why.
- Proposals for equity plan approval should describe how the board determined the number of shares to be requested, including:
  - Number of shares available under current plan
  - Expected duration of new share authorization
  - Past history of grants, including burn rate
  - Dilutive impact
- Consider providing separate share limits for directors in equity plans; perhaps even separate plans

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# **ISS AND GLASS LEWIS CONSIDERATIONS**

## Equity Plan Approval

- Review your shareholder base to determine whether the shareholders follow Institutional Shareholder Services, Inc. (ISS) or Glass Lewis recommendations, or their own internal guidelines.
- Whether or not you subscribe to ISS' services, sign up for the [ISS Equity Plan Data Verification portal](#) (no charge).
  - ISS will send a confirmation of the data on which its recommendation will be based. Upon receipt of the ISS data confirmation, you will have two business days to verify the data or request modifications if the data is incorrect.

## ISS Equity Plan Scorecard

- Review ISS scorecard policy for evaluating equity compensation plan proposals
  - The Equity Plan Scorecard Policy (EPSC) is based on a holistic analysis and is intended to be more flexible than the past ISS analysis
  - Departure from the pass/fail analysis previously performed by ISS
  - EPSC uses a point system, with 53 out of a maximum 100 total points required to pass the EPSC model

## ISS Equity Plan Scorecard

- EPSC considers a range of factors based on three “pillars”:
  - Plan Cost
  - Grant Practices
  - Plan Features
- Factors within each pillar are not weighted equally
- In allocating points:
  - Some factors are all or nothing
  - Some factors may generate a partial portion of available points
- Consideration of sacrificing points for flexibility



## ISS Equity Plan Scorecard

- Plan cost looks at:
  - New shares plus currently available shares plus shares covered by outstanding grants
  - New shares plus currently available shares
  - Considering the share reserve with and without outstanding grants helps companies that have large numbers of outstanding stock options

## ISS Equity Plan Scorecard

- Grant practices looks at grants made in the past three years
  - Three-year burn rate
  - Grants to CEO
  - Plan duration
  - Clawback policy
  - Holding requirements

## ISS Equity Plan Scorecard

- Plan features gives points for:
  - No liberal share recycling
  - Minimum one-year vesting
  - No discretion to accelerate vesting (other than upon death, disability or change in control)
  - Dividends on RSUs and PSUs vest on same vesting terms as underlying award
  - Limited vesting upon change in control

## ISS Evaluation of Equity Plan Proposals

- In 2017 ISS made several changes to its equity plan scorecard
- In order to receive full points for minimum vesting, all types of awards must have minimum vesting
  - Full points will be earned if the equity plan specifies a minimum vesting period of one year for all award types
  - No points will be earned if the plan allows individual award agreements to provide for less than a minimum of one year of vesting
- Discretionary acceleration of vesting is a separate category, with no points given if committee has power to accelerate vesting other than upon death, disability, or change in control
- Points given for tying vesting of dividends to vesting of the underlying awards

## ISS Evaluation of Equity Plan Proposals

- ISS may override the equity plan scorecard for problematic pay practices such as:
  - Liberal “change in control” definition, which includes the ability to modify the change in control definition
  - 280G tax gross-up
  - Plan allows repricing of options without shareholder approval
  - Other plan features or company practices that are deemed detrimental to shareholders

## ISS Evaluation of Equity Plan Proposals

- If plan is amended to allow increased share withholding for taxes (i.e., share withholding above the minimum rate) and the plan has liberal share counting with respect to those shares, ISS may recommend against the plan
  - This issue can be addressed by providing that the shares withheld above the minimum rate will not be added back to the share reserve
- Proposals seeking only approval to ensure tax deductibility of awards pursuant to Section 162(m) generally will receive a favorable recommendation as long as the committee administering the plan consists entirely of independent outsiders
  - ISS will not necessarily give a favorable recommendation if the 162(m) proposal is “bundled” with plan amendments contained in the same proposal

## Non-Employee Director Equity Plans

- ISS updated its policy on evaluating non-employee director equity plans
  - Two new factors: relative pay magnitude and meaningful pay limits
- On a case-by-case basis, ISS will evaluate:
  - Estimated cost relative to peers
  - Three-year burn rate relative to peers
  - Presence of any “egregious” plan features

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# **BEST PRACTICES AND OTHER CONSIDERATIONS**



## Equity Plan Approval

- When considering share authorization, review share overhang (outstanding equity grants as compared to outstanding shares), burn rate (share usage) over the last several years (usually three years), the company's projected need for shares over the next several years (usually three to four years), and, if applicable, ISS' assessment of the allowable share authorization.
- Review the individual limits on equity grants and cash awards to make certain they are high enough to cover any unanticipated situations, and make sure the plan administrators and compensation consultants understand these limits.
- Review the performance metrics that are included in the plan for Section 162(m) performance-based compensation (if applicable) to make sure they cover all performance metrics that may be used.

## Equity Plan Approval

- Consider imposing a meaningful limit on the number of shares that may be granted to non-employee directors under the plan to address recent Delaware litigation. For example, a plan can impose an annual share limit on director grants or an annual limit on the fair market value of shares or total compensation to be granted to directors.
- Give the compensation committee and board of directors sufficient time, preferably in more than one meeting, to review the proposed share authorization, the plan changes, and the rationale for the share increase and plan changes.

## Equity Plan Approval

- Include in the proxy a detailed discussion of the reasons for the share authorization and the board's analysis.
- Include information in the proxy about share overhang and burn rates to ensure that ISS, Glass Lewis, and shareholders have clear data with which to perform their analysis. Double-check all share numbers in the proxy, including the numbers in the proxy table for outstanding shares under equity plans, to ensure that they are consistent and will not be confusing to ISS, Glass Lewis, or shareholder reviewers.
- Make arrangements for the updated Form S-8, plan prospectus, and equity grant documents to be ready as of the date of the shareholders' meeting.

## Litigation Considerations

- Numerous lawsuits have been filed seeking to enjoin annual meetings based on alleged deficiencies in the proxy statement disclosures related to equity compensation plan proposals
- Plaintiffs' firms closely scrutinize company proxies, search for inadequate disclosures, and file nuisance lawsuits
- Plaintiffs' firms allege breaches of fiduciary duty, aiding and abetting based on perceived disclosure deficiencies
- Lawsuits threaten to postpone annual meetings
- To date, courts have generally dismissed claims

## Specific 162(m) Litigation

- Plaintiffs' firms have claimed breach of fiduciary duty, corporate waste, and unjust enrichment for failing to structure grants as "qualified performance-based compensation" under section 162(m)
- Plaintiffs have claimed false or misleading disclosure with respect to section 162(m) plans and grants
- Plaintiffs have claimed failure to comply with the section 162(m) plan requirements

## 162(m) Recommendations

- Ensure plan language and proxy do not guarantee that every award will qualify as “qualified performance-based compensation” under section 162(m)
- Seek reapproval of material terms of section 162(m) provisions when shares are added to the plan. 162(m) provisions must be re-approved every five years.
- Include clear disclosure that approval is for section 162(m)

**QUESTIONS?**

# Biography



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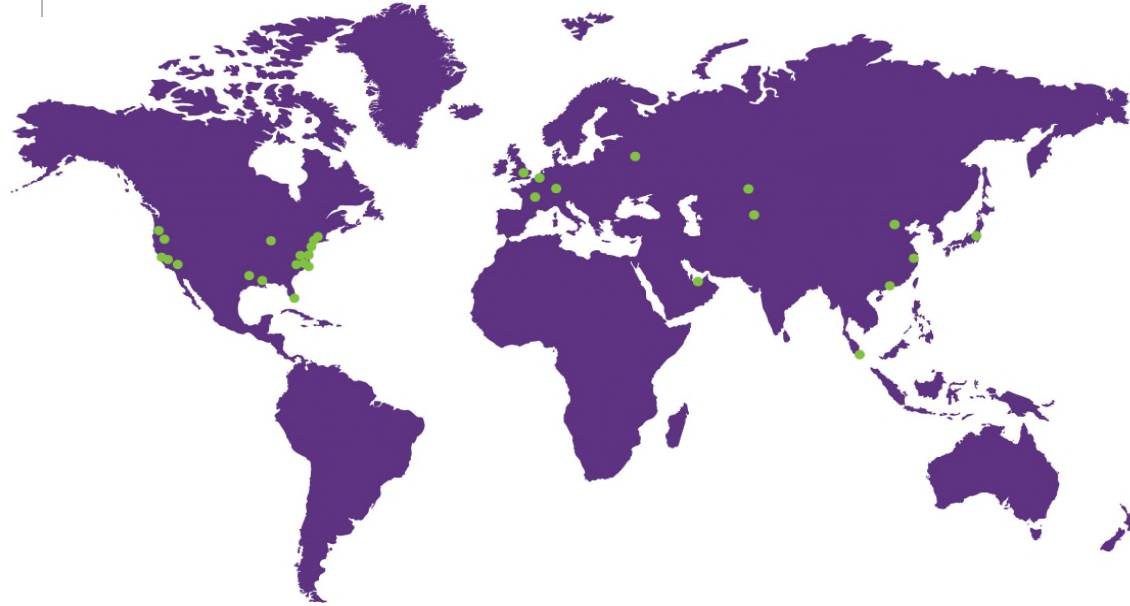


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