

# Preparing for Proxy Season: Start Now

**Presentation for:**  
Executive Compensation Webinar Series  
September 12, 2024

**Presentation by:**  
Anthony J. Eppert  
[AnthonyEppert@HuntonAK.com](mailto:AnthonyEppert@HuntonAK.com)  
512.542.5013

## Housekeeping: Questions

- Questions during this presentation
  - We encourage questions (even though your audio lines are muted)
  - To submit a question, simply type the question in the blank field of the menu bar and press return
  - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail after this presentation

## Housekeeping: Recording, CE Credits and Disclaimer

- Recording
  - This presentation is being recorded for internal purposes only
  
- Continuing education credits
  - A purpose of the webinar series is to provide FREE CE credits
  - To that end, each presentation is intended to provide 1 credit hour in the following areas:
    - CLE: 1 credit hour (CA, FL, GA, NC, NY, TX and VA)
    - CPE: 1 credit hour (Texas)
    - HRCI: This activity has been approved for 1 (HR (General)) recertification credit hours toward California, GPHR, PHRi, SPHRI, PHR, and SPHR recertification through the HR Certification Institute
    - SHRM: This program is valid for 1 PDC for the SHRM-CPSM or SHRM-SCPSM
  - If you have any questions relating to CE credits, please direct them to Anthony Eppert at [AnthonyEppert@HuntonAK.com](mailto:AnthonyEppert@HuntonAK.com) or 713.220.4276
  
- Disclaimer
  - This presentation is intended for informational and educational purposes only, and cannot be relied upon as legal advice
  - Any assumptions used in this presentation are for illustrative purposes only
  - No attorney-client relationship is created due to your attending this presentation or due to your receipt of program materials

## About Anthony “Tony” Eppert



Anthony Eppert , Partner  
Hunton Andrews Kurth LLP

Tel: +1.713.220.4276

Email: [AnthonyEppert@HuntonAK.com](mailto:AnthonyEppert@HuntonAK.com)

- Tony practices in the areas of executive compensation and employee benefits
  
- Before entering private practice, Tony:
  - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
  - Obtained his LL.M. (Taxation) from New York University
  - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
    - Editor-in-Chief, Journal of Medicine and Law
    - President, Tax and Estate Planning Society

## Upcoming 2024 Webinars

- 2024 webinars:
  - Governance: Properly Hiring and Terminating an Executive Officer (10/10/24)
  - Introduction Course on Employment Taxes (11/14/24)
  - What Happened in 2024: Year-End Review of Compensatory Items(12/12/24)

Sign up here: <https://www.huntonak.com/en/insights/executive-compensation-webinar-schedule.html>

## Our Compensation Practice – What Sets Us Apart

- Compensation issues are complex, especially for publicly-traded companies, and involve substantive areas of:
  - Tax,
  - Securities,
  - Accounting,
  - Governance,
  - Surveys, and
  - Human resources
  
- Historically, compensation issues were addressed using multiple service providers, including:
  - Tax lawyers,
  - Securities/corporate lawyers,
  - Labor & employment lawyers,
  - Accountants, and
  - Survey consultants

## Our Compensation Practice – What Sets Us Apart (cont.)

- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation



# Our Compensation Practice – What Sets Us Apart (cont.)

- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

## Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

## Corporate Governance

- Implement “best practices”
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

## Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

## Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

## Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

## International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

- According to an ISS report issued on September 11, 2024:
  - Say on pay proposals passed at a higher rate than the prior year
  - Median S&P 500 CEO pay was at a historic high of \$15.6mm (whereas median CEO pay in the Russell 3000 was up from prior year, but not at a historic high)
  - Median S&P 500 CEO pay increased by \$1.3mm (whereas median CEO pay in the Russell 300 increased to \$300,000)
  - Median support for equity plans increased by more than a percentage point
  - Evergreen provisions within equity plans continued to increase
  - The number of compensation-related shareholder proposals decreased

## ISS Influence

- If an issuer receives less than a 70% pass rate, then ISS will perform a qualitative review at the next annual meeting of the issuer's responsiveness to shareholder opposition, and if such responsiveness is lacking, then ISS might recommend an Against on the reelection of the Compensation Committee members. To that point, responsiveness includes:
  - Efforts that the Board took with respect to shareholder engagement
  - The specific feedback the issuer received from dissenting shareholders, and
  - What actions or changes the issuer made to its pay programs and practices to address concerns of its shareholders
  
- And too, statistics support that an “Against” recommendation from ISS creates a drop in the pass rate by approximately 25%-30% or more
  
- ISS will recommend an Against vote on the issuer's say-on-pay proposal if any of the following are present:
  - Significant misalignment between CEO pay and issuer performance;
  - Problematic pay practices exist such as excessive change-in-control pay or severance pay, repricing of options, tax gross-ups or perquisites; or
  - Board's responsiveness to shareholders is poor

## Possible Items of Interest for Fall 2024

- Compensation Committee concerns will be very similar to its concerns in prior years, such including:
  - Volatility of stock price and its impact on compensation arrangements such as dollar-denominated conversion ratios, stock ownership policies, relative total shareholder return and similar performance metrics;
  - Protecting against underwater stock options;
  - Addressing long-term performance metrics that are not likely to pay out;
  - Addressing change-in-control retention issues in the context where the employer is or might be the target;
  - Addressing retention issues for executives who otherwise could receive a “fresh grant” of equity if he or she took employment with another entity; and
  - SEC disclosures

## Annual Grant Policy

- This topic is not new. Having a documented annual grant policy could provide an affirmative defense to an allegation that the equity grant was intended to time the market
  - It is common practice that grants of equity awards are first denominated in dollars (e.g., 100% of base salary), and then converted into a number of shares
  - An issue with the foregoing is whether shareholders might allege that the executives took advantage of a downward slide in stock price by timing dollar denominated equity award grants to coincide with low stock price, thus resulting in a higher share award than if the stock retained a higher stock price
  
- And too, the SEC’s guidance on spring-loaded equity awards is yet another reason why issuers should consider adding an annual grant policy. Under such guidance:
  - Spring-loading occurs when an equity award is granted just prior to a public announcement that the issuer expects will increase its stock price
  - There are two issues with spring-loaded grants. First, the compensation expense will be lower than it would have been had the award been granted immediately following such public announcement. Second, for issuers with dollar-denominated grants, the executive will have received more shares than he or she would have received if the grant occurred after the public announcement
  - The SEC guidance differentiates between routine and non-routine grants, and implies that routine grants might not be subject to close SEC scrutiny. Thus, a routine grant pursuant to an annual grant policy could help to avoid the issue of spring-loaded equity awards

# Shrinking Labor Market – Succession Strategy Thought

- The cost of retaining key employees will likely increase as the baby boomers continue to exit the workforce
- And too, fertility rates have dropped. According to the Centers for Disease Control and Prevention:
  - The fertility rate in the U.S. is projected to be 1.786 births per woman in 2024
  - Such is below the replacement rate 2.1 children per woman needed to maintain a stable population
- It is anticipated that a thinning labor market will become the norm even in the face of, or during, an economic downturn
- Is it too soon to perform an assessment to determine whether retention gaps exist within the issuer’s compensation structure?
  - Consider adding a “retirement” provision within equity award agreements and key employee employment agreements that allow for accelerated vesting (all or some) if the key employee terminates his or her employment due to retirement
  - BUT . . . Require advance notice (e.g., 6 months, 12 months) advance written notice before the key employee can effectuate such retirement
  - Such advance notice could help an issuer with its succession strategies by providing the issuer with time to find and train a successor key employee

## Stock Price Volatility: Underwater Stock Options

- This slide sets up the factual problem:
- Outstanding stock options run the risk of becoming underwater and a drag on the share reserve of the equity incentive plan
- If the Compensation Committee desires to reprice underwater stock options, the issuer would have to file a Schedule TO with the SEC unless:
  - The repricing is conducted on an individually negotiated basis with a small number of key executives (see March 21, 2001 SEC Exemptive Order); or
  - A repricing is permitted unilaterally (*i.e.*, without optionee consent), thus negating the Schedule TO rules because there is no “offer” and the optionee would not have to make an investment decision
    - However, a significant drawback to a unilateral repricing is that incremental compensation expense could be significant since a “value-for-value” exchange cannot be effectuated (such requires optionee consent because a lesser number of shares generally results under the amended award)
  - And too, other issues must be considered when repricing stock options, such as:
    - Whether the cancelled shares return to the share reserve under the equity plan;
    - Whether shareholder approval is required under the terms of the equity plan and under applicable NYSE/NASDAQ listing rules (answer is most likely yes that such approval is required); and
    - Whether adverse tax and accounting consequences could be avoided

# Stock Price Volatility: Underwater Stock Options (cont.)

- A possible idea to fix the prior problem could be to insert a stock-price forfeiture provision
- The stock option award agreement would provide that if the stock option ever becomes underwater by \$x.00 (or the stock price ever falls by \$y.00), then both the vested and unvested portions of the stock option are automatically and immediately forfeited for no consideration
  - Depending on the equity plan’s terms, the forfeited shares would return to, and act to replenish, the share reserve of the equity plan
- The goal is avoid the time, expense and shareholder relationship issues associated with repricings and compliance with the SEC’s tender offer rules
- Risk to be vetted
  - Under NYSE and NASDAQ listing rules, a cancellation followed by a **required** regrant is deemed to be a repricing, which generally would require shareholder approval
  - This “cancellation” issue will need to be vetted by legal counsel
  - A possible solution to consider is whether a cancellation followed by a **voluntary** grant (the latter of which would be pursuant to a written or operational annual grant policy) would sufficiently negate the nexus between a cancellation and regrant, thus negating the repricing characterization

## Insufficient Shares: Inducement Grants

- Under applicable NYSE and NASDAQ listing rules, shareholder approval is not required for “inducement grants”
- To qualify as an inducement grant, the grant of restricted stock or stock options must act as a material inducement to the person being hired as an employee (or such person being rehired following a bona fide period of interruption of employment)
  - Inducement awards include grants of equity to new employees in connection with an M&A transaction
- Inducement grants must be approved by the Compensation Committee or a majority of the issuer’s independent directors
- An additional qualification requirement is that promptly (generally within 4 business days) following the grant of an inducement award, the issuer must disclose in a press release the material terms of the award, including the identity of the recipient(s) and the number of shares involved, and make certain other filings with the applicable listing agency

## Insufficient Shares: Inducement Grants (cont.)

- In terms of the “form” of award, some issuers provide inducement grants as stand-alone awards, whereas others will have an inducement plan from which to make grants
  - The latter is particularly prevalent in M&A transactions
- Important to note is that inducement grants are “outside” of the shareholder approved equity incentive plan
  - Therefore, inducement grants would have to comply with an applicable securities exemption or be covered pursuant to a Form S-8 or other securities registration

## Insufficient Shares: Inducement Grants (cont.)

- Our thoughts generally:
  - Depending on the extent an issuer grants equity to new hires, compliance with the inducement grant exception could substantially increase the life expectancy of a shareholder-approved share reserve (*i.e.*, equity grants tend to be larger in new hire situations)
  - Inducement grants could be used in the M&A context where a buyer offers equity to the key employees of the target entity
  - However, burn rate and dilution profiles relative to industry peers could be negatively impacted, thus making it more likely that ISS would recommend “against” to any future request to increase the share reserve for the issuer’s equity incentive plan (*i.e.*, an inducement plan essentially borrows from the share reserve of a future shareholder-approved equity incentive plan)
  
- Our thoughts for any issuer considering implementation of an inducement program:
  - Consider the structure of any inducement program
    - If inducement grants will be frequent, then draft an inducement plan
    - But if inducement grants will be infrequent, then approve stand-alone inducement grants on an ad hoc basis
  
  - Have an inducement grant (or plan) be covered by a Form S-8

## Don't Forget Next Month's Webinar

- Title:
  - Governance: Properly Hiring and Terminating an Executive Officer
  
- When:
  - 10:00 am to 11:00 am Central
  - October 10, 2024